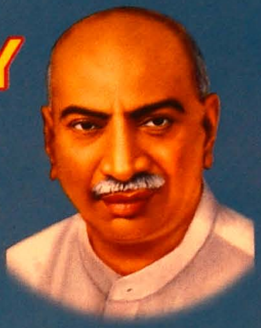
MADURAI KAMARAJ UNIVERSITY

(University with Potential for Excellence)



DISTANCE EDUCATION

M.B.A.

SECOND YEAR

IV SEMESTER
ELECTIVE II - FINANCE

MANAGEMENT OF FINANCIAL INSTITUTIONS

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MANAGEMENT OF FINANCIAL INSTITUTIONS

I. Objectives :

This course aims to provide a clear understanding of financial system, financial institutions and their various services.

II. Syllabus :

Indian Financial system – an overview.

1. Financial Market :

Capital market – Stock Market – Finctions – Players –Legal aspects and regulatory norms.

Money market – Call money market, Treasury bills market, Commercial bills market, Markets for commercial paper and certificats of deposits, Discount market, Market for financial guarantees, Gift edged securities market, Industrial securities market.

International dimensions of financial market.

2. Financial Institutions :

Banking institutions – RBI – Commercial Banks, Foreign Banks and Private sector Banks – Cooperative Banks – Structure and Functions.

Non-banking financial institutions – Role, function and regulatory aspects - chit funds, Nidhi and Benefit funds.

3. Development of Financial Institution :

IDBI, ICICI, IFCI, IRBI, RCF, TIIC, TIDCO, SIPCOT, ITCOT, SIDCO, SIDBI. Emerging roles, structures, Management issues, advent of foreign financial institutions, competition and diversification plans of these DFI's.

4. Insurance sector :

LIC, GIC – Functions, organisations & various services – Role in financial market. Deregulation in Insurance Industry and the new Insurance bill before the parliament.

5. Mutual Funds :

UTI & Other Private Mutual funds, Regulatory aspects, Functions. Various types of funds, calculation of NAV, Present scenario in India.

Credit rating agencies: Roles, competition to healthy capital markets, Ehtical issues, Regulatory aspects.

III. Recommended Text Books :

Financial institutions and markets.	Meir Kohn	TMH

IV. Reference Books :

The Indian Financial System	Vasant Desai	Himalaya Publishing House
Financial institutions and Markets	L.M.Bhole	Tata Mc.Graw Hill Publishing Company Ltd.
Management of Inadian Financial Institutions	R.M. Srivastava	Himalaya Publishing House

Introduction

Money lending in one form or the other has evolved along with the history of the mankind. Even in the ancient times there are references to the moneylenders. Shakespeare also referred to 'Shylocks' who made unreasonable demands in case the loans were not repaid in time along with interest. Indian history is also replete with the instances referring to indigenous money lenders, Sahukars and Zamindars involved in the business of money lending by mortgaging the landed property of the borrowers.

Towards the beginning of the twentieth century, with the onset of modern industry in the country, the need for government regulated banking system was felt. The British government began to pay attention towards the need for an organised banking sector in the country and Reserve Bank of India was set up to regulate the formal banking sector in the country. But the growth of modern banking remained slow mainly due to lack of surplus capital in the Indian economic system at that point of time. Modern banking institutions came up only in big cities and industrial centres. The rural areas, representing vast majority of Indian society, remained dependent on the indigenous money lenders for their credit needs.

Independence of the country heralded a new era in the growth of modern banking. Many new commercial banks came up in various parts of the country. As the modern banking network grew, the government began to realise that the banking sector was catering only to the needs of the well-to-do and the capitalists. The interests of the poorer sections as well as those of the common man were being ignored.

In 1969, Indian government took a historic decision to nationalize 14 biggest private commercial banks. A few more were nationalized after a couple of years. This resulted in transferring the ownership of these banks to the State and the Reserve Bank of India could then issue directions to these banks to fund the national programmes, the rural sector, the plan priorities and the priority sector at differential rate of interest. This resulted in providing fillip the banking facilities to the rural areas, to the under-privileged and the downtrodden. It also resulted in financial inclusion of all categories of people in almost all the regions of the country.

However, after almost two decades of bank nationalization some new issues became contextual. The service standards of the public sector banks began to decline. Their profitability came down and the efficiency of the staff became suspect. Non-performing assets of these banks began to rise. The wheel of time had turned a full circle by early nineties and the government after the introduction of structural and economic reforms in the financial sector, allowed the setting up of new banks in the private sector. The new generation private banks have now established themselves in the system and have set new standards of service and efficiency. These banks have also given tough but healthy competition to the public sector banks.

This material is intended to provide the various service offered by the commercial banks and financial institutions to promote the economic development of a country. This book is divided into ten units which cover the whole aspects of financial institutions and its services.

MANAGEMENT OF FINANCIAL INSTITUTIONS

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UNIT – 1

FINANCIAL AND BANKING SYSTEM IN INDIA

1.1 Introduction
1.2 Unit Objective
1.3 Unit structure
1.3.1 Classification Of Financial System
1.3.2 The Function of the Indian Financial System
1.3.3 Composition of the Indian Financial System
1.3.4 The Indian Banking System
1.3.5 The composition of the Indian Banking System
1.3.6 Scheduled and Non-scheduled Banks
1.3.7 Sub-Markets in the Indian Money Market
1.4 The Indian Capital Market
1.5 Summary
1.6 Keywords used in the lesson
1.7 Further reading
1.8 Answer to check your progress question
1.9 Model Questions

Introduction :

Finance is the study of money and its behaviour and its administration. The financial system includes all those activities dealing in finance. The financial system comprises of financial institutions, financial markets, financial instruments and financial services. In a broad sense, finance refers to funds or monetary resources needed by individuals, business, houses and the Government. Individuals and households require funds essentially for meeting their current requirements or day to day expenses or for buying capital goods.

A business unit needs funds for paying wages and salaries, for buying raw metarials, for purchasing new machinery or replacing an old one. Traders require finance for buying and stocking goods in their shops and godowns. The Government needs funds to pay salaries to its staff, to meet its ependiture on goods and services and finance its development programme.

1.1 Unit Objective

- To gain knowledge about financial system in India
- To become familiar with the basics about the money market and capital market
- To identify the scheduled banks and non scheduled banks

1.3.1Classification of Financial System:

The financial system of India refers to the demand for and the supply of funds of all individuals, institutions, companies and of the Government and to the system of borrowing and lending of funds. Commonly, the financial system is classified into:

(i) Industrial Finance: Funds required for the conduct of industry and trade.

(ii) Agrcultural Finance: Funds needed and supplied for the conduct of agriculture and allied activity.

(iii) Development Finance: Funds needed for development of agriculture and industry.

(iv) Government Finance: It relates to the demand for and supply of funds to meet Government expenditure.

India's financial system includes the many institutions and the mechanism which affects the generation of savings by the community, the mobilization of savings and the effective distribution of the savings among all those who demand the funds for investment purposes. Broadly, therefore, the Indian financial system is composed of:

(a) The banking system, the insurance companies, Mutual funds, investment and other institutions which promote savings among the public collect their savings and transfer them to the actual investors, and

(b) The investors in the country composed of individual investors, industrial and trading companies and the Government.

Apart from these two broad catagories of institutions which promote savings on the one side and investment on the other, there are certain other essential insitution of the Indian financial system which are actually facilitators, i.e., they facilitate savings and investment in the country. For example, the new issues Market facilitate or guides new savings to floe into new issues of stocks and shares. In the same way, the stock exchanges in India facilitate the buying and selling of shares and debentures of exisitng companies and thus help savers to shift from one type of investment to another. The new issuse market land the stock exchange may not promote savings and investment directly but they facilitate savings on the one side and help the transfer of funds for investment, on the other. The new issue market and the stock exchange are thus components of the Indian financial system.

Check Your Progress

1. Funds required for the conduct of industry and trade is called as -------.
2.] Indian financial system facilitates ----- in the country

The Function of the Indian Financial System :

The Indian financial system performs a crucial role in economic development of India through saving-investment process, also as capital formation. It is for this reason that the financial system is sometimes called the financial market. The purpose of the financial market is to mobilise savings effectively and allocate the same efficiently among the ultimate users of funds, viz, investors.

It is generally accepted that a high rate of capital formation is an esseintial condition for rapid economic development. Now the process of capital formation depends upon.

(a) Increase in savings, that is, the resources that would have been normally used for consumption purposes, can be released for other development purposes.

(b) Mobilisation of savings –domestic saving collected by banking and financial institutions and placed at the disposal of actual investors : and

(c) Investment proper, which is the production of capital goods.

The third stage or process is the real capital formation but this stage cannot arise or exist without the first two processes. Thus, the general public should save and be prepared to release real resources from consumption goods to capital goods. The savings of the people should be mobilised by banking and financial institutions. Finally, the savings of the people should be made available to investors to produce capital goods. All these three steps or processes, though independent of each other, are necessary for accumulation of capital. The importance of Bankong and financial institutions in the capital formation process arises because those who save and those who invest in India are generally not the same persons or institutions. The financial institutions and the banks act as intermediaries to bring the savers and investors together.

1.3.2 Composition of the Indian Financial System :

The Indian financial system which refers to the demand for and supply of funds or to borrowing and lending of funds consists of two parts, viz., the Indian Money Market and the Indian Capital Market.

The Indian money market is the market in which short-term funds are borrowed and lent. The money market does not deal in cash or money but in bills of exchange-trade bills and treasury bills and othet instruments, which are drawn for short periods. The capital market in India, on the other hand, is the market for medium-term and

Check Your Progress

3. The ------------- is the market in which short-term funds are borrowed and lent.

4. The --------- is the market for raising medium-term and long term funds.

long term funds. The organisation and structure of the Indian financial system can be explained with the help of a chart.

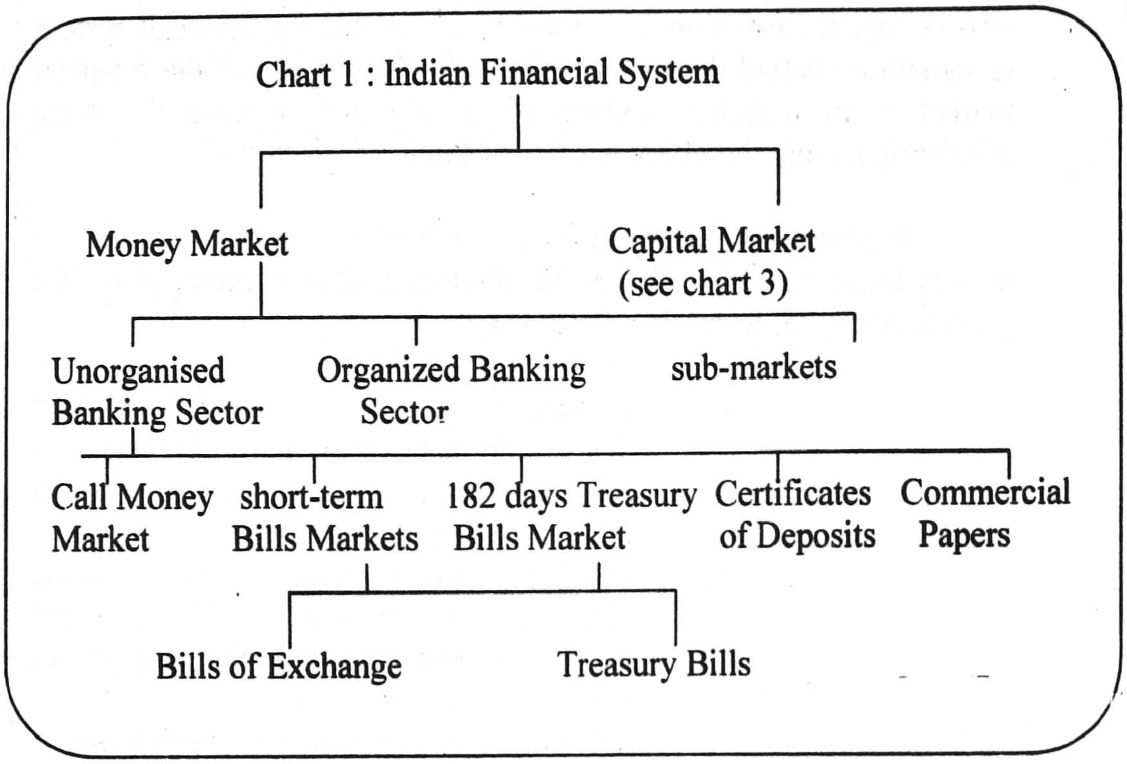

Chart 1 : Indian Financial System

1.3.4 The Indian Banking System :

Usually we classify the Indian money market into unorganised and organized sectors. The unorganised sector consists of indigenous bankers in the country who pursue banking buisness on traditional lines. The unorganised secctor comprises moneylenders and indigenous bankers and caters to the credit needs of a large number of persons in the country side. The organised sector of the Indian money market consists of commercial banks in india-public sector and private sector banks and foreign banks commonly called foreign exchange banks. The Reserve Bank of India, as the Central bank and monetary authority in the country, is the leader of the Indian money market. RBI has made many changes in the instruments and institutions in the Indian money market.

The Major supplier of funds in the Indian money market is the commercial banks. The promoter's savings of the general public-they offer safety and security for the savings of the public and offer incentives in the form of interest on bank deposits. Apart from mobilising savings of the general public, especially of the lower and middle income groups, the commercial banks create credit by simply promising to pay or meet the requirements of borrowers. This is an important aspect of short-term money.

Check Your Progress

5. ---------- is the leader of the Indian money market.

6. The central bank of the country known as ---------.

1.3.5 The composition of the Indian Banking System :

The organised banking system in India can broadly be divided into three catagories, viz, the central bank of the country known as the

Reserve Bank of India is the supreme monetary and banking authority in the country and has the responsibilities to control the banking system in the country. It keeps the reserves of all commercial banks and hence is known as the "Reserve Bank".

Commercial banks have been in existence for many decades. Commercial banks mobilise savings in urban areas and make them available to large and small industrial and trading units mainly for working capital requirements. After 1969 commercial banks are broadly classified into nationalised or public sector banks and private sector banks. The State Bank of India and its associate banks along with another 20 banks are the public sector banks. The private sector banks include a small number of Indian scheduled banks which have not been natonalised and branches of foreign banks operating in India commonly known as foreign exchange banks.

Chart 2 :
The Indian Banking System

- Reserve Bank of India(Central Bank & Monetary Authority)
  - Commercial Banks
    - Public Sector
      - State Bank Group
        - State Bank of India
        - Associate Banks
      - Other nationalised banks
    - Private Sector
      - Indian
      - Foreign
  - Regional Rural Banks
  - Co-operative Banks
    - State Co-operative Banks
      - Central Co-operative Banks
        - Primary Credit Societies

The Regional Rural Banks (RRBs) came into existence in the middle of 1970s with the specific objective of providing credit and deposit facilities particulaly to the small and marginak farmers, agricultural labourers and artisans and small entrepreneurs. The Regional Rural Banks have the responsibility to develop agriculture, trade, commerce and industry in rural areas. The RRBs are essentially commercial banks but their area of operation is generally limited to a district.

Primary Co-operative Credit Societies (Which are really banks) were originally set up in village to promote thrift and saving of the farmers and to meet their credit needs in cultivation. The support them, central or district originally based in the rural sector, the co-operative banks coming under State co-operative bank..

Check Your Progress

7. The branches of foreign banks operating in India are known as --

1.3.6 Scheduled and Non-scheduled Banks :

Under the Reserve Bank of India Act, 1934, banks were classified as scheduled banks and non-scheduled banks. The scheduled banks are those which are entered in the Second Scheduleof RBI Act, 1934. Such banks are those which have a paid-up capital and reserves of an aggregate value of not less than rs.5 lakhs and which satisfy RBI that their affairs are carried out in the interests of their depositors. All commercial banks Indian and foreign, regional rural banks and state co-operative banks are scheduled banks. Non-scheduled banks are those which have not been included in the Second Schedule of RBI Act, 1934, at present. there are only four or five non-scheduled banks in the country.

1.3.7 Sub-Markets in the Indian Money Market :

The Indian money market is not a single homogeneous market but it is composed of several sub-markets, each one of which deals in particular types of short-term credit. The call money market is the market for extremely short period loans-sometimes only for a day or for a few days. Often the loans dealt with in this market are known money at call and short notice. These loans are commonly known as call loans since the banks which deal in the market can recall them at the shortest possible notice. The commercial banks are the major players in the call money market as they are the lenders. The borrowers are individual's traders, speculators and others who need funds for very short periods.

The bill market or the discount market is the most important part of the money market where short-term bills-normally upto 90 days are brought and sold. The bill market is further sub-divided into commercial bill market and Treasury bill market.

In recent years, a new instrument known as 182 days Treasury bill has been introduced in India and with it the 182 Treasury bill market has emerged. The other important markets are the markets for certificates of deposits (CDs) and commercial papers (CPs).

1.4 The Indian Capital Market :

Check Your Progress
8. All commercial banks Indian and foreign, regional rural banks and state co-operative banks are ----

The Indian capital market is the market for long-term capital; it refers to all the facilities and institutional arrangements for borrowing and lending "term funds"- medium term and long-term funds. The demand for long-term money capital comes predominantly from private and public manufacturing industries, trading and transport units, etc. The Government is also a big borrower of funds for development purposes; and agricultural to requires some funds for long-term purposes. The Central and State Government require substantial amounts from the capital market. The supply of funds for

the capital market comes largely from individuals savers (they supply through banks and insurance companies), corporate savers, commercial banks, insurance companies, public provident funds and other agencies. The capital market in India can be described as follows:

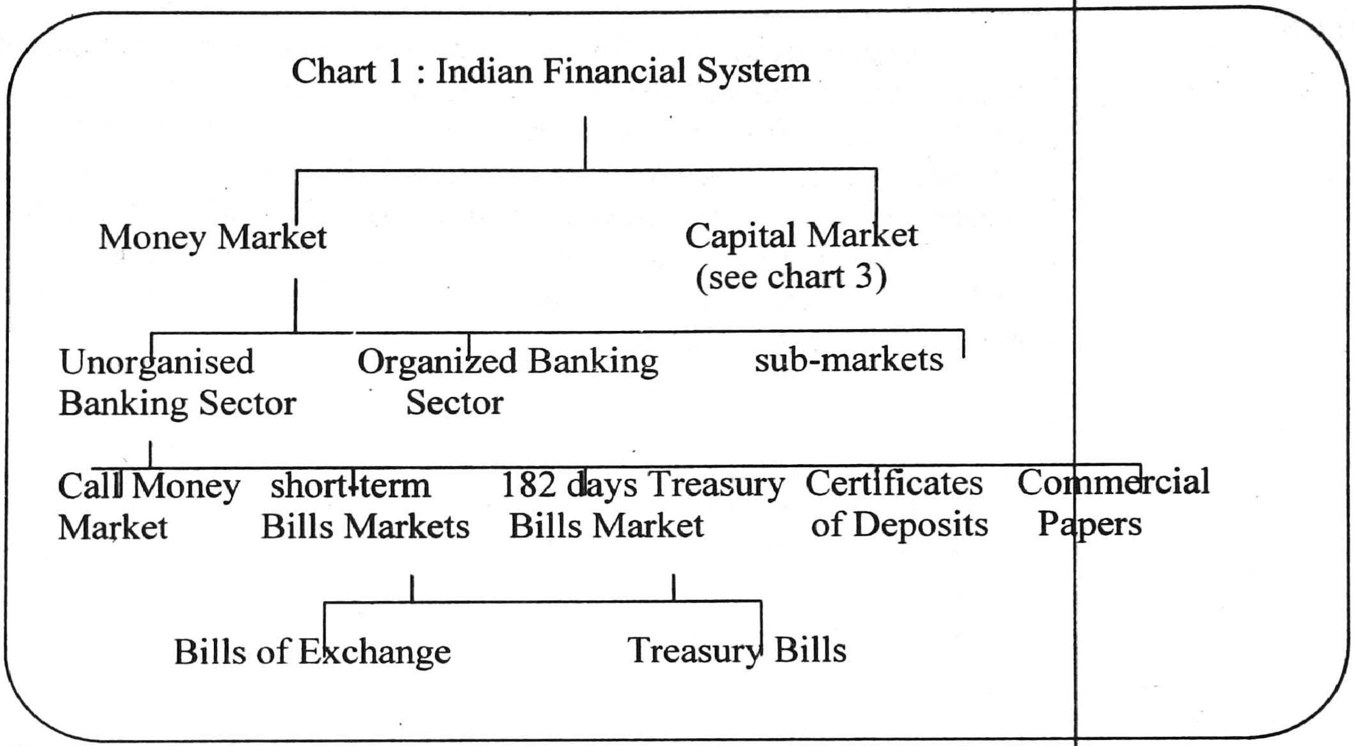

Chart 1 : Indian Financial System

The gilt-edged securities market is the market exclusively for Government securities which carry fixed interest rates. The industrial securities market is the market for equities and debentures of companies of the corporate sector. This market is further classified into (a) new issuse markets for raising fresh capital in the form of shares and debentures, and (b) old issuse markets for buying and selling and debentures of existing companies- this market is commonly known as the stock market or stock exchange.

Industrial and trading houses raise funds directly for investment from banks and other financial institutions. The important sources of long-term capital are :

(a) Commercial banks are important lenders to investors but generally they are interested in government securities and to a small extent in debentures of the corporate sector.

(b) Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) are two public sector non-baking financial institutions who are major players in the capital market.

(c) Development financial institutions which were set up by the government after independence-the Industrial Finance Corporation of India(IFCI) the Industrial Credit and Investment Corporation of India(ICICI), Industrial Development Bank of India(IDBI), etc all these

institutions provide long-term capital on the corporate sector directly and form part of the capital market.

1.5 Summary:

Apart from these institutions in the Indian money market and Indian capital market, these are some which play a very important role in the Indian financial system. We refer to the apex banking and financial institutions like RBI, IDBI, EXIM Bank, Natonal Bank for Agriculture and Rural Development (NABARD) which have been set up in recent years like the discount and finance house of india Ltd.(DFFHI) in the money market, Mutual Funds, leasing Companies, etc., in the capital market.

1.6 Keywords used in the lesson

- Financial system
- Money market
- Capital market

1.7 Further reading

✓ Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book

✓ Indian Stock Market by Bishnupriya Mishra

✓ The Indian Financial System: Markets. Institutions and Services, 3/e, by Bharati V. Pathak

1.8 Answers to check your progress questions

1. Industrial finance
2. Savings and Investment
3. Money market
4. Capital Market
5. Reserve Bank of India
6. Reserve Bank of India
7. Foreign Exchange Banks
8. Scheduled Banks

1.9 Model Questions

1. What do you understand by Scheduled banks?
2. What are the various classifications of Financial Systems?
3. Discuss in detail about the Indian financial system.
4. Discuss various aspects of Capital Market.

FUNCTIONS OF DEVELOPMENT BANKS

2.1 Introduction
2.2 Unit Objective
2.3 Unit structure
2.3.1 Financial Gap-Fillers
2.3.2 Commercial Banking Business of Development Banks
2.3.3 Joint Finance
2.3.4 Interest Rate Policy
2.3.5 Credit Guarantee
2.3.6 Refinance and Development Banks
2.3.7 Entrepreneurial Gap-Fillers
2.3.8 Development Banks and Capital Market
2.3.9 Bond Issues
2.3.10 Underwriting the subscription of Stocks-Debentures
2.3.11 Safe of Securities
2.4 Summary
2.5 Keywords used in the lesson
2.6 Further reading
2.7 Answer to check your progress question
2.8 Model Questions

2.1 Introduction:

Development Banks have two-fold functions-Financial and Promotional. Their functions are much more closely related to those of the investment banking institutions of advanced countries, although they are intended to be pump primers rather than supply conducts for the factors of production and they usually have to perform a greater variety of functions. Generally speaking, a development bank is multipurpose institutions in the sense of financing projects in the various sectors of the economy.

2.2 Unit Objective

- To know the functions of development banks
- To identify the various forms of assistance provided by development banks

2.3 Functions of Development Banks :

2.3.1 Financial Gap-Fillers :

Provision of medium and long-term loans, equity participations, subscriptions to bonds and debentures of the companies, underwriting of their shares, and of bonds or debentures issued by them guaranteeing loans raised from foreign or domestic sources, and also guarenteeing of deferred payments for machinery imported or purchased within the country are the usual forms in which finance is furnished by the development banking institutions.

NOTES

2.3.2 Commercial Banking Business of Development Banks :

Normally, provision of permanent or fixed working capital needs should be financed out of the paid-up share capital of the concern. But in the developing countries (With ill organised and imperfect capital market) where the banking system is immature and credit facilities are inadequate, development banks may have to step forward to fill the vacuum and provide short-term credit to their customers for working capital purposes. Industrial Development Ccrporation of Nepal, The Mexican National Financiers and the South African Industrial Development Corporation provide working capital when their loanee companies are unable to raise it from other sources. As regard other kinds of commercial banking business such as accepting of deposits, opening letter of credit or discounting of bills etc., by development banks there is no uniform practice.

2.3.3 Joint Finance :

A special feature of considerable importance in the development bank's operations, in recent years is the joint financing of projects in close collaporation with other financial institutions. Such joint financing becomes necessary, because of the constraints of financial resources in one side and legal constraints, as to quantum of assistance, on the other side.It is difficult for one single institution to meet the entire financial requirements of a project both loan capital and underwriting of share capital. Not only in the case of large projects, but also in the case of medium-sized projects, it may be necessary for a concern to have, for instance, the requirements of a foreign exchange loan in a particular currency, met by one institution and underwriting or guarantee requirement met by another. In the case of projects, such as fertilisers,
Petro-chemicals, ferrous and non-ferrous metals, cement, paper etc., requiring large capital outlay, and therefore, substancial financial assistance, is given either through joint finance or through a consortium of long-term financial institutions, commercial banks, etc.

The members of the consortium work in close co-operation with each other by mutual exchange views and co-ordination of policies and procedures. In so far as appraisal of projects involving joint financing is concerned, there is a joint appraisal by a team of technical and financial offers of the institutions concerned co-ordination amongst financial institutions is also achieved through periodical 'Inter-Institutional' meetings convened under the saegis of the Central Bank of the country where the chief executives of the institutions meet and discuss problems of common interest.

Check Your Progress
1. Permanent or fixed working capital needs should be financed out of the --------.

2.3.4 Interest Rate Policy :

Normally, any financial institution engaged in term-lending will frame its interest rate policy based upon the Bank rate, the cost of raising its own funds, its administrative expenses, the building up of some reserves and an adequate return to its stock holders. The rate interest charged by development banks may be determined either by outside authorities or by economic factors likr the demand for loans or both.

Normally, there will be a link between the development banks' lending rate and the market rate. S.K.Basu contends that charging lower interest than the market may be regarded as a gift and consequently "marginal" and "sub-marginal" firms may come into existence. The chances of their failure in the long run would be increased, besides the scarce capital being frittered away instead of going into priority and most productive areas. Moreover, charging lower rates than the overall market rates may give a sharp edge to the activities of development banks to the detriment of other financial institutions, thereby hampering the healthily development of the capital market.

In India, the doctrine of differential rate of interest for industrial loans to be provided by development banks has also been recommended by RBI and differences in the lending rate exist on the considerations of loan required, regions (Backward or forward), currency requirement (Local or foreign), types of industries and also the size of the industrial units (small, medium or large).

2.3.5 Credit Guarantee :

The main deterrent to the extension of loan by financial institutions to small scale industries is the element of risk generally associated with it. To overcome this risk, Credit Guarantee Scheme and Credit Insuarance have been introduced in several countries like Japan, India, etc. In India, the credit Guarantee Scheme was introduced in 1960 by the Government of India. The objective of the scheme is to enlarge the supply of institutional credit to small industrial against possible losses in repsect of such advances. In Japan, besides Credit Guarantee and Credit Insurance, the Credit Agency system is also highly developed. The financial institutions use the service of these agencies to get information on the credit worthiness of applications and take decisions on their loan applications, with the guidance of the agencies. In Netherlands, a Guarantee Fund is also established in each branch of an industry by businessman, to help deserving colleagues in getting loans for a new venture.

Check Your Progress

2. The credit Guarantee Scheme was introduced in the year ----- by the Government of India.

3. The objective of the Credit Guarantee Scheme is to enlarge the supply of institutional credit to small industrial against----------in

2.3.6 Refinance and Development Banks :

Another incentive which encourages financail institutions to increase their commitment into industrial finance is the availabiltiy of the refinance facility. Granting of term-loan to industries greatly afffects the liquidity of the financing institutions because a considerable amount of money is getting locked up fairly for a longer period. But when refinance is made available to the lending institutions it increases latters liquidity thereby enabling it to take up fresh investment proposals in India, the Industrial Development Bank India provides refinance against term-loan granted to industrial concern by SFCs Commercial Banks and State Co-operative Banks (Primary lenders). The sanction procedure in respect of loans to the small scale sector has been simplified and put on near-automatic basis. Normally, the minimum amount of loan, refinanced is Rs.10 lakhs. Lower minimum limits have also been stipulated in respect of loans to (a) small scall units covered under the Credit Guarantee Schemes of the Central Government or unit promoted by technician entreneurs cover under the special GUARANTEE SCHEME (b) small road transport operators and (c) house boats. The maximum amount of loan eligible for refinance will be Rs.90 lakhs per unit. However in the case of projects jointly assisted by SFC, SIDC, Commercial Banks etc., the total refinance from IDBI will be extended upto Rs.150 lakhs.

2.3.7 Entrepreneurial Gap-Fillers :

Although the hardcore of the activities of a development bank is financing, it undertake the task of bringing together the elements essential to modern industrial development, of providing the element that may be missing in a particular case and of carefully blending the elements so that the pace of development may be quiknened. Indeed in some cases the promotional role is more significant than the role of the industrial financier.

Discovery of investment projects, the promotion of industrial enterprises, the provision of various kinds of technical and managerial assaistance, the undertaking of economic and technical research, the conducting of survey work and feasibility studies, stimulation of the capital market, etc., constitute the important aspects of the promotional functions of development bank. While discharging these functions, they act on one side as agents for executing for Government's investment projects and on the other side, act as catalyst for investment in the private secor. This involves an evolution of investment projects in the light of the declared objectives of the industrial policy of the government. Thus development banks are aptly described as the conerstone of the modern industrial financing system.

Check Your Progress
4. The maximum amount of loan eligible under refinance will be ------- per unit.

2.3.8 Development Banks and Capital Market :

Development of the capital market is the most important non financial activity of a financial bank. The association between the institutional arrangements of a country's capital market and its economic progress is very close. To achieve self-
Sustaining economic growth, the easy availability of savings for financing produtive projects is very important; this requires, in turn, an effective capital market to mobilise savings to the desired channels in order to stimulate efficient allocation of available funds into competing ends. It is imperative for the capital market to create a variety of financial assets and to ensure their liquidity, marketability, stability and satisfactory yield. The developments Banks are the keystone of the capital market in developing economics are expected to perform these functions and thereby promote the growth of their capital markets.

Development Banks can help capital market through some or all the following activities; (a) sale of their own obligations in the capital market, (b) placement of their industrial security holding, (c) underwriting the issue of new securities, (d) inducting investors of participate in their financial operations. Besides, these banks can mobilise savings from the public by way of accepting deposits from the latter, assist stock exchanges by engaging themselves in the sale and purcahse of corporate securities and devise new forms of securities to suit different sector of the investing public.

2.3.9 Bond Issues :

Most of the development Banks have found it convenient to issue their own obligations. This is mainly due to the fact that the bond issues of many banks are guaranteed by government with regard to minimum rate of return and repayment of the principal. For instance, the industrial Finance Corporation of India, and State Financial Corporation (including the Tamil Nadu Industrial Investment Corporation) have the legal authority to issue bonds and debentures with Government.

2.3.10 Underwriting the subscription of Stocks-Debentures :

Development Banks acquire industrial securities through either direct subscription or underwriting or both. Sometimes they also acquire securities through their promotion of companies or \ and by conversion of their loans into equities. Thus they can build up portfolios of industrial stocks and bonds. But it should be noted that these securities usually are not meant for permanent retension. This is because that a real development banks should not hold on the stock bonds. These securities should be disivested slowly but steadily without upsetting either the stock market price, or control over management of companies which issued them. This is because, a sudden disposal may cause a glut in the stock market resulting either in

the price fluctation or even passing the securities into the hands of any particular party who may acquire controlling interest in a company. Hence the disposal should ensure wide disposal securities into the hands of individual or institutional real investors. It is even more desirable to consult the company which issued them before offering such securities to the public. For instance, the IFCI sells shares generally in small lots through recognised stockbrokers and at times in bigger lots to institutions like Life Insurance Corporation (LIC) of India or Unit Trust of India (UTI).

2.3.11 Safe of Securities :

By offering such securities for public sale, the development banks significantly contribute to the growth of the capital market. Such operations may
result in enlarging the supply of marketable securities may even attract new buyers, and create favourable attitude and confidence among investors for buying and holding industrial securities. The sale of securities from portfolio is not only beneficial but also necessary for development bank. This operation enables them to get back the funds already locked up for further investment and to release the enterprises, if any, established by them from their control and management. Thus, underwriting by development banks in the developing or underdeveloped countries is not only a marketing function but also an investing function.

This ICICI, IFCI, SFCS, (including TIIC) and the South African Industrial Development Corporation have followed the practice of selling shares and bonds out their own portfolio from time to time and utilising the proceeds for new investments which may later on augment the market supply of securities. In few cases, there is an obligation on the part of the development bank to dispose any shares it acquired as a result of underwriting. For instance the original Act of IFCI contained a provision to the effect that it had to dispose any shares it acquired as a result of underwriting within seven years irrespect of the conditions in the capital market. Ordinarily, only, those shares considered for sale which are quoted substantially above par and where the institution expects a reasonable premium on its investment. On the above basis and after talking into account the current market quotations, IFCI fixes from time to time floor prices below which no shares are sold. The ICICI sells securities from its own portfolio to investors whenever it can get a reasonable price for them. Generally, it does not retain successful investment merely because they are profitable.

The success of the development Bank's efforts to self securities from their portfolio may be significantly influenced on the one side by the firm of securities and on the other side by the state of the development of the capital market. In under development developing economics with inflationary conditions, equities may be more readily marketable than bonds. However, if bonds are of fairly short maturity

and economic conditions are comparatively stable, bonds may find favour with investors.

When the capital market is continuously sluggish and stagnant, development banks which have engaged in share underwriting operations may have to take up and hold considerable amounts of their underwriting commitments and may also have to wait for a favourable turn of the market to be able to dispose of the securities. Thus, it is clear that underwriting will be meaningful only when there is a fair prospect of success for a public issue.

2.4 Summary

The growth of development banking is now a worldwide phenomenon. Development banks have become well recognised segment of the financial market. They are artificial limbs created to compensate for the relatively show growth like normal sources of finance to industries. Development banks are often expected to play an important role in the promotion of the widespread ownership of industrial securities particularly in developing countries, what role they actually take will be dependent on the environment in which they operate.

2.5 Keywords used in the lesson

- ✓ Commercial banks
- ✓ Joint finance
- ✓ Forms of assistance

2.6 Further reading

1. Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book
2. Indian Stock Market by Bishnupriya Mishra
3. The Indian Financial System: Markets, Institutions and Services, 3/e, by Bharati V. Pathak

2.7 Answer to check your progress question

1. Share capital
2. 1960
3. Losses
4. 90 lakhs

2.8 Model Questions

1. Discuss the functions of development banks.
2. Write a short notes on
   a. Joint finance
   b. Interest Rate Policy
   c. Credit Guarantee
   d. Refinance
   e. Underwriting

UNIT – 3
PERFORMANCE OF THE INDIAN FINANCIAL SYSTEM

3.1 Introduction
3.2 Unit Objective
3.3 Unit structure
3.3.1 Performance of the Economy
3.3.2 Industrial and Trade Policies
3.4 Financial Sector
3.4.1 Capital Market
3.4.2 Development Finance
3.4.3 Operations of Financial Institutions
3.5 Summary
3.6 Keywords used in the lesson
3.7 Further reading
3.8 Answer to check your progress question
3.9 Model Questions

3.1 Introduction :

The Indian economy is passing through a difficult phase caused by several unfavourable domestic and external developments. Domestic output was adversely affected by poor performance in agriculture in previous two year. The global economy experience an over all decleration and is estimated to record an output growth of 2.4 percent during the past year. These tendencies were exacerbated in the after that of the terrorist attacks in USA in September 2001. Consequently export growth has suffered and industrial profitability has also been affected by the prevailing low commodity and product prices globally. Despite these constraints, growth is real GDP in 2001-2002 is expected to be 5.4 percent as estimated by the central statistical organisation. This growth rate marks some recovery over the low growth of 4 percent in 2000-01. It will also be one of the highest growth rates in the world in the current year.

3.2 Unit objective

- To know the performance of the Indian financial system
- To identify the performance of the economy
- To find the operation of the financial institutions

3.3.1 Performance of the Economy :

There was a moderate growth of 3.8% in the Gross Domestic Product (GDP) in 1993-94 as compared to 5% in the previous year mainly on account of lower growth in the agricultural sector (1.8% as against 4.3% in 1992-93). The manufacturing segment of industrial production recorded a growth rate of 2.2% as compared to 0.7% on previous year. The infrastructure sector continued to perform satisfactorily in 1993-94 coal production was up by 3.3%, electricity generation increased by 7.4%, decline in crude oil production was

arrested and the revenue earning freight traffic handled by railways increased by 1.7%. The price situation eased further during the early part of the year; however, it started increasing in the last quarter of the year consequent to increase in prices of some infrastructure industries. Though inflation rate measured on point-to-point increase in wholesale prices increased from 7% in March 1993 to 10.2% inn March 1994, on average basis, it declined to 8.3% from 10% in 1992-93. Towards December 1994, the inflation rate was in the region of 9%.

The year was characterised by an impressive growth in exports making it one of the most outstanding features of the economy's performance. Exports are estimated to have risen by 19.6% to US $22.2 billion as compared to a growth of only 3.8% in the previous year. Imports, which were slow to pick up in the first three quarter indicating revival in the industrial sector: Imports during the year aggregated US $ 21.8 billion in 1992-93. Trade deficit in 1993-94 was US $ 23.2 billion as against US $ 21.8 billion in 1992-93. Trade deficit in 1993-94 was US $ 1 billion as compared to US $ 3.3 billion in 1992-93. India's balance of payments (BOP)' situation in the fiscal year 1993-94 remained comfortable. Private investment flows in the form of Foreign Direct Investment and Foreign portfolio investment (both FIIs and Euro-issues) were a major new phenomenon in the BOP situation of the year. These aggregated US $ 4.75 billion in 1993-94 which was 14 times higher than those in 1992-93. The improvement in the balance of payment position and substantial inflow of foreign capital is reflected in the level of forex reserves (excluding gold and SDRs) which rose to US $ 15.1 billion as at end March 1994 from US $ 6.4 billion as at end March
1993. The forex reserves expanded further considerably aggregating US $ 19.6 billion as at end October 1994.

The average annual growth rate during the Ninth Five Year Plan (1997-2002) is now estimated at 5.4 percent which is lower than the plan target of 6.5 percent. The Indian economy has been resilient in the several external shocks during this period such as the East Asian crisis of 1997-98, the oil price increase of 2000-01, and the most recent world economic slowdown. Domestic shocks in the shape of adverse security environment natural disasters like the Orissa Cyclone and Gujarat earthquake, and two consecutive years of poor agricultural performance, have also been faced successfully by the economy. The overall growth of 5.4 percent in 2001-02 is supported by a growth rate of 5.7 percent in agriculture and allied sectors, 3.3 percent in industry and 6.5 percent in services. The average annual rate of inflation inn terms of the wholesale price index increased significantly from 3.3 percent in 1999-2000 to 7.1 percent in 2000-01 due to a substantial fix in administered prices of Petroleum Products.

3.3.2 Industrial and Trade Policies :

With a view to giving greater play to competitve forces and globalisation, several policy measures were introduced to deregulate the industrial sector during the year. Delicensing was extended to more industrial sectors and the number of areas reserved for the public sector was reduced to six. The private sector was permitted entry into 13 mineral sectors earlier reserved for the public sector. The Government announced new eligibility criteria for increase in foreign equity in existing companies. The Government also revised the guidelines for determining the issue price of preferential shares. The Government announced a new sugar policy which allowed fresh incentives for sugar mills. Molasses and alcohol produced as a by-product of sugar production were decontrolled and free market forces were allowed to determine their prices. The corporate tax rate was reduced from 45% for widely held companies and 50% for closely held companies to a uniform 40%. The tax rate for foreign companies registered abroad but operating in India was reduced from 65% to 55%. A five year tax holiday was announced for new industries in industrially backward states and for power generation.

The Government on Disinvestment of Shares in Public Sector Enterprises submitted its report to the Government during the year recommending that the percentage of equity to be divested should be 49% for industries reserved for public sector and 74% in other cases. The committee on industrial sickness and corporate restructing submitted its report to the Government recommending measures for early detection of incipient sickness and that a sick corporate Restructuring submitted its report to the Government recommending measures for early detection of incipient sickness and that a sick company' reference to BIFR (Board for Industrial and Financial Reconstruction) may be voluntary rather than mandatory. During the year, various measures were introduced for the promotion of small scale industries. A new legislation viz. Interest on Delayed payments Act 1993 was enacted to ensure prompt payment to small scale units. RBI announced a special package of measures to ensure timely and adequate credit to small scale sector. A new National Telecom Policy was announced by the government with the focus of bringing telecom within the reach of all and the introduce competiton in the field of basic telecom services thus allowing private parties to participate in the expansion of the telecommunication network and provide value-added services.

During the year, further modifications were made in the trade policy with a view to not only sustaining the tempo of export growth but also on acclerating it in the future. The Union Budget 1994-95 announced full convertibility of the rupee on the current account and reduced the peak custom duty rates from 85% to 65%. Exports and foreign exchange earners are now permitted to retain 25% of their foreign exchange earnings, whereas 100% EOUs are to retain 50% of

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their export earnings. The Exim Policy 1992-97 was further liberalised during the year. The export Promotion Capital Goods Scheme was simplified and third party exports were permitted for fulfilling export obligation. Procedures were simplified to facilitate exports including those from EQUs and EPZs. A new category of Star Trading Houses with higher import entitlement was created. The negative list was further pruned and there was an expansion of the list of items to be imported against special licences.

The significant slowdown of industrial growth witnassed in 2000-01, as measured by the index of industrial production, continued with greater intensity in 2001-02. There was a distinct decleration in growth of manufactured exports and slowdown in growth of manufactured exports and slowdown in growth rates of care and infrastructure industries. The overall industrial growth in terms of the IIP during April-December 2001-02 was only 2.3 percent compared to 5.8 percent during the corresponding period of the previous year. Industrial slowdown has been deserved across all major sectors. The manufacturing sector grew by only 2.4 percent during April-December 2001, much lower than the 6.0 percent growth registered during the same period in 2000.

3.4 FINANCIAL SECTOR :

3.4.1 Capital Market :

A major development in the capital market during the year was the setting up of several private sector mutual funds. The securities and Exchange Board of India (SEBI) introduced a number of measures for streamlining the functioning of the secondary market, such as reconstitution of the boards of stock exchanges, capital adequacy norms for brokers and for providing transparency in broker\client relationship. It also introduced a code of advertisement for public issues for ensuring fairs and truthful disclosures. With a view to streamlining the primary market, SEBI raised the size of minimum application to 500 shares and introduced the system of proportionate allotment in public issues. Companies were also allowed to offer a larger portionof their issues to mutual funds on preferential basis. The Government also gives recognition to the National Stock Exchange which commenced trading in its wholesale debt market segment on June 30, 1994 and in the capital market segment on November 3, 1994.

During 1993-94, there were 1154 public and rights issues by the private corporate sector seeking to raise an amount of Rs.21,846 crore as against 1051 issues for Rs.18,695 crore in 1992-93. Significantly, rights issues constituted almost half the amount proposed to be raised. An important trend in the market was the increase in the number of Indian companies accessing the international capital markets. During the year, 27 companies raised US $ 2.5 billion through Global Depository Receipts\convertible bonds from the international

Check Your Progress
1. SEBI stands fot -----.

capital markets as compared to US $ 240 million in 1992-93. The Government announced guidelines for companies seeking to raise resources through euro-issues. The secondary market witnessed substantial buoyancy towards the end of thhe year dut to the increase in the flow of FII funds and shortage of scrips arising out of leading Indian companies opting for GDR issues. There has been a continuous increase in the number of FIIs registered with SEBI. Up to November 1994, SEBI had registered 241 FIIs.The FIIs have so far invested over US $ 1 billion in the secondary markets. SEBI issued guidelines to enable companies to make preferential offer of securities to FIIs. The Union Budget 1994-95 reduced the tax on short term capital gains of FIIs to 30% while long term capital gains would be taxed at 10%. The RBI announced the setting up of the Securities Trading Corporation of India.

The Developments in the stock market on the eve of the current financial year brought to the fare the need for further measures aimed at promoting safety, transparency and efficiency of capital market. Accordingly, the following measures were announced in March 2001.

(i) Intension to Corporatise stock exchanges involving segregation of ownership management and trading membership from each other.

(ii) Extension of rolling settlement to two hundred 'A' category stocks in Modified Carry Forward Scheme (MCFS), Automated Lending and Borrowing Mechanism (ALBM) and borrowing and Lending Securities Scheme (BLESS) by 2, 2001.

The pronounced bearish sentiments in the stock market saw the sense falling to 3184 on April 12, 2001, which implied a cumulative fall of 36.3 percent from 5001 at the end of March 2000. The adverse sentiments in the secondary market also affected the mobilisation of resources from the primary market. The amount raised through public issue and right issue during the first nine months of the current year Rs.3777 crores. Resource mobilisation during this period, through IPOs Rs.208 crores which is accepted for only 5.5 percent of the total resources mobilisation, compared to about 56.7 percent in the corresponding period of the previous year.

3.4.2 Development Finance :

Several new policy initiatives were taken by the financial institutions and banks continued to read just their role and refocus their operations in line with changing environment. The Industrial Finance Corporation of India Ltd. (IFCI) offered its equity to public, which SCICI and Industrial Credit and Investment Corporation of India Ltd. (ICICI) accessed overseas markets by offering convertible bonds. IDBI, IFCI and ICICI offered the option of variable interest loans on a

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selective basis to their clients. The institutions also announced a phased reduction in their lending rates. In October 1994, Government promulgated an ordinance to amend the IDBI Act enable it to restructure its paid up capital, raise equity from the public and to impart greater operational flexiblity. Almost all financial institutions have plans to enter into newer areas and are in the process of setting up separate companies for the purpose. IDBI is in process of setting up a commercial Bank, a mutual fund and a stock broking subsidiary. IFCI also has proposed to set up separate subsidiaries for undertaking registrar & transfer services, custodial services and stock broking. ICICI has set up an investor's services company a commercial bank and a mutual fund which have commenced operations. UTI investors Services Company, stock broking firm and commercial bank also have commenced operaions. During the year, RBI issued guidelines on asset classification, income recognition and capital adequacy norms for financial institutions IDBNI issued similar guidelines for state-level institutions. A committee set up by the Government to review the SFCs Act finalised its report which is under the consideration of the Government.

Further restructuring of commercial banks was undertaken during the year. The Government made a provision of Rs.5600 crores to provide additional share capital to public sector banks. During the year, State Bank of India raised Rs.2146 crore through a public and rights issue and Rs.1000 crore through a bond issue. In October 1994, Oriental Bank of Commerce also raised Rs.360 crore through a public issue of equity. In August 1993, the Recovery of Dept Due to Banks and Financial Insitutions Act 1993 was passed by the Parliament which would enable the establishment of Special Recovery Tribunals to help banks financial institutions in the speedy recovery of their dues. The committee on reforms in the Insurance Sector set up by the Government has recommended progressive deregulation of the insurance sector to create a more competitve and financially strong insurance industry.

3.4.3 Operations of Financial Institutions :

Overall assistance sanctioned by all financial institutions (AFIs) viz., IDBI, IFCI, ICICI, SIDBI, IRBI, SCICI, RCTC, TDICI, TFCI, LIC, GIC, UTI, SFCs and SIDCs during 1993-94 aggregated Rs. 42,448.4 crore recording a rise of 26.3% over the previous year. Disbursements went up by 15.2% to 26,629 crore over the same period. Assistance sanctioned by All-India Developments banks viz., IDBI, IFCI, ICICI, SIDBI, IRBI and SCICI increased by 44.6% to Rs.31,357.9 crore , while those of investment institutions fell by 14.6% to Rs.10,765 crore. The specialised financial institutions registered a rise of 23% to Rs.1196.2 crore. Assistance sanctioned by SFCs was lower by 5.3% at Rs.1900.4 crore and by SIDCs was lower by 3.8% at 936.2 crore. Cumulatively, up to end-March 1994, AFIs sanctioned

Check Your Progress

2. ---------------- help banks and financial institutions in the speedy recovery of their dues.

assistance aggregating Rs.1, 95,974.4 crore and disbursed an amount of Rs.1, 38,067.4 crore.

3.5 Summary

The Government of India takes various measures for promoting economic development of country by framing Industrial and Trade policy. Also, financial institutions play a major role for increasing GDP of country.

3.6 Keywords used in the lesson

- ✓ Industrial and trade policy
- ✓ Financial institutions
- ✓ Development finance

3.7 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book

Indian Stock Market by Bishnupriya Mishra

The Indian Financial System: Markets, Institutions and Services, 3/e, by

Bharati V. Pathak

3.8 Answer to check your progress question

1. Securities Exchange Board of India
2. Special Recovery Tribunals

3.9 Model Questions

1. What do you know about the composition of Indian Financial System?
.2. Is the Indian Capital Market adequately structured?
3. How is the performance of the Indian Capital Market during 2000-2001?
4. Write a brief note on the industrial trade policies pursued by the country during 2010-11.
5. Write that notes on

i. Refinance & Development Banks.

ii. Underwriting the subscription of stocks.

iii. Sale of securities.

UNIT – 4
WORKING OF CENTRAL LEVEL INSTITUTIONS

4.1 Introduction
4.2 Unit Objective
4.3 Unit structure
4.3.1 Industrial Development Bank of India (IDBI)
4.3.2 Industrial Finance Corporaton of India Ltd (IFCI)
4.3.3 Industrial Reconstruction Bank of India (IRBI)
4.3.4 Industrial Credit and Investment Corporation of India Ltd (ICICI)
4.3.5 Unti Trust Of India (UTI)
4.3.6 Life Insurance Corporation of India (LIC)
4.3.7 General Insurance Corporation of India (GIC)
4.3.8 Small Industries Development Bank of India (SIDBI)
4.3.9 Non-Banking Financial Institutions (NBFI)
4.4 Summary
4.5 Keywords used in the lesson
4.6 Further reading
4.7 Answer to check your progress question
4.8 Model Questions

4.1 Introduction:

Financial institution plays a vital role for the industrial development of the country. It provides assistance to medium and large industries by way of various facilities such as direct finance refinance of industrial loans and bills finance.

4.2 Unit objectives:

- To identify the various financial institutions and its role for the economic development
- To analyse the performance of various financial institutions

4.3.1 Indusrial Development Bank of India (IDBI) :

The Industrial Development Bank of India (IDBI), set up on July 1, 1964 under an Act of parliament as the principal financial institution for industrial development in the country, provides assistance to medium and large industries by way of various facilities such as direct finance, refinance of industrial loans and bills finance. It also provides resource support to financial institutions and other intermediaries in the form of loans and investments. The Small Industries Development Bank of India (SIDBI), a wholly owned subsidiary of IDBI, provides assistance to the small scale sector. Besides extending finance under its new products such as asset credit, equipment finance, equipment leasing, bridge loans and corporate loans. IDBI also provides merchant banking, debentures trusteeship and forex services to the corporate sector.

Check Your Progress
1.The Industrial Development Bank of India (IDBI) was set up on__________

4.3.1.1 Functions of IDBI :

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The main function of the IDBI, as its name itself suggests is to finance industrial enterprises in both private and public sector. Those enterprises which can get help from the Development Bank include manufacturing mining, processing, shipping and other transport industries and hotel industries. Financial assistance is provided either directly or through specified institutions.

(i) Direct Assistance: IDBI assists industrial assists directly by way of project loan, underwriting of and direct subscription to industrial securities (Shares and Debentures), soft loans, technical development fund loans and equipment finance loans. Project loans, underwriting and direct subscription and soft loans together account for 98 percent of the total direct assistance sanctioned by IDBI these days.

IDBI provides direct assistance for projects costing more than Rs.3 crores under the Project Finance Scheme. Such projects are generally assisted on a consortium basis with other all-india financial institutions and commercial banks. Assistance is extended under the scheme for new projects expansion diversification of existing projects by way of term loans (both rupee and foreign currency), underwriting of subscription to shares and debentures and financial guarantees (both rupee and foreign currency) for deferred credits and loans raised from other sources.

(ii) Indirect Assistance : IDBI's indirect assistance is provided basically to tiny, small and medium enterprises mainly-

(a) By way of refinance of industrial loans granted by SFCs, SIDCs, commercial banks, co-operative banks and RRBs.

(b) Rediscounting of bills arising out of sale of indigenous machinery on deferred payments basis, and

(c) Seed capital assistance to new enterpreneurs generally through SFCs and SIDCs.

(iii) Special Assistance: The Industrial Development Bank of India Act, 1964, the creation of a special fund known as the Development Assistance Fund. This Fund is to be used by the IDBI to assist those industrial concerns which are not able to

Check Your Progress
2. Under the Project Finance Scheme, IDBI provides direct assistance for projects costing more than _______.

secure funds in the normal course either because of heavy investment or because of low rate of return of both. The Develpoment Assistance Fund was created out of an initial cotrbution made by the Central Government and it is increased by way of loans, grants, donation, etc., from thhe Government and from other sources. The existance of other Fund was a special feature of IDBI.

(iv) General: The role of IDBI extends beyond the provision of the financial and other assistance to industrial concerns. The bank can undertake promotional activities such as marketing and investment, research and surveys and carry out techno-economic studies. It can provide technical and administrative assistance to any industrial enterprises for promotion, management or expansion. Above all, it has to play a "positive role in the processing of industrialisation through planning, promoting and developing new industries to fill the gaps in the industrial structure of the country".

It is interesting to note that unlike other existing statuory financial corporations, IDBI has no restriction imposed regarding the nature and type of security which it should accept. The bank has a large degree of discretion. It is of course, prohibited from lending on the security of its own bonds or debentures.

4.3.1.2 Schemes Operated by IDBI :

1. Direct Assistance for project loan and Non-project loan (Item I-XV)

2. Indirect Assistance for Refinance (for medium and large scale units) and Bills Rediscounting Schemes (Items XVI & XVII)

3. Services under merchant Banking, Debenture Trusteeship and Forex. (Item XVIII)

(i) Project Finance Scheme

Objective	To provide long term finance for setting up of new, expansion and diversification fo projects and modernisation
Eligibility	Any industrial concern conforming to the definition in Section 2 of IDBI Act.

(ii) Asset Credit Scheme

Objective	For Acquiring and for fabrication of new equipment / machinery.
Eligibility	• Financially sound companies • Should have declared dividend atleast for latest 3 years - Good track record.

iii) Equipment Finance Scheme

Objetive	For acquiring specific machinery / equipment
Eligibility	• Financially sound companies • Should have been in operation for atleast 5 years and declared dividend for atleast for latest 3 years
Nature of assistance	Rupee and Foreign Currency Loan

(iii) Direct Discounting Scheme

Objective	For selling machinery / equipment
Eligibility	• Financially sound companies • Should have been in operation for atleast 3 years
Nature of Assistance	Annual limit for discounting of bills(Rupee)

(iv) Short term loan

Objective	For meeting long term working capital margin requirements
Eligibility	• Financially sound companies • Should have been in operation for atleast 5 years and declared dividend for atleast 3 years
Nature of Assistance	Rupee loan

Check Your Progress

3. ____________ is provided for Acquiring and for fabrication of new equipment / machinery.

4. ____________ are provided to meet long term working capital margin requirements

(v) Bridge Loan

Objective	Short term Funds against Rights / Public issue
Eligibility	• New as well as existing companies • Issue to be fully underwritten. • SEBI approval • Lead manager appointed.
Nature of assistance	Rupee Loan

(vi) Equipment Lease Finance

Objective	For purchase of equipment on lease basis
Eligibility	• Existing company havving a track record of good operational performance • New companies are not eligible. • Outstanding lease rentals should not exceed Rs.10 crores or networth whichever is less
Nature of assistance	Financial lease only

(vii) Assistance to Leasing Finance Company

Objective	To extend financial assistance to leasing finance companies engaged in leasing and hire purchase business.
Eligibility	• Minimum credit rating of A/FA/MA • Five years in Leasing / Hire Purchase Business • Minimum business of Rs. 5 crores in previous year • Outstanding leased assets and stock-on-hire should be atleast Rs.10 crores. • Leasing and Hire Purchase business should account for atleast 50 of total business (not applicable for public sector) • Minimum networth Rs.3 crores

	• Dividend record to be consistent • Real estate companies not eligible.
Nature of assistance	Rupee Loan

(viii) Khoka Purchase Scheme

Objective	To provide liquidity to a NCD issue and hence, promote the market for debt instruments.
Eligibility	Financially sound companies – Profit making and dividend paying
Nature of assistance	Rupee Loan

(ix) Innovative Funding for Energy Conservation (Infuse)

Objective	To assist the industrial unit for adopting latest energy conservation technologies
Eligibility	Financially should companies with a good operational performance
Nature of assistance	Conditional Rupee Loan
Extent of assistance	80% of the project / equipment cost subject to: Minimum – Rs.50 lakhs Maximum – Rs.1000 lakhs

(x) Venture Capital Finance

Objective	To provide assistance to encourage commercial application of indigenously developed technology or adapting imported technology to wider domestic applications. To encourage projects involving higher than normal risks and giving higher than normal returns.
Eligibility criteria	Industrial concerns under clause "C" of section 2 of IDBI Act, 1964
Nature of assistance	Rupee Loan Equity upto 50% Convertible / Unconvertible debentures

(xi)Equipment Finance for Energy Conservation

Objective	To provide assistance to finance equipment for effecting Energy conservation.
Eligibility criteria	Financially sound undertakings in operaion for atleast 5 years
Nature of assistance	Rupee Loan

(xi) Corporate Loan Scheme

Objective	To provide finance for Capital expenditure and core working capital
Eligibility criteria	Financially sound companies satisfying certain criteria for the last three years.
Nature of assistance	Rupee Loan / Foreign Currency Loan

(xii) Debenture Trusteeship

Objective	To represent and protect the interests of debenture bond holders
	Company should have a) Compiled with SEBI guidelines for issue of debentures / bonds b) Fixed Assets Cover 1.25:1 c) D/E not exceeding 2:1 d) Interest Cover 2:1 e) Current Ratio 1.33:1 f) Obtained credit rating, as per SEBI requirement
Size of Debenture Issue	Minimum limit for public issue – Rs.100 lakhs

Check Your Progress
5 The assistance provided to encourage commercial application of indigenously developed technology or adapting imported technology to wider domestic applications, which is called as __________.

(xiii) Energy Management Consultation & Trainig (EMCAT) Project

Objective	To improve Technological and Management capabilities for supply and end-use of energy by private sector industry.
Eligibility	Financially sound companies willing to incur the expenditure for energy saving as identified by Project Report

Nature of assistance	- Consultants, it foreigner has to be from US - Rupee grant or FC grant

(xiv) Refinance for medium scale industries

Objective	To finance medium scale industries through eligible institutions for eligible activity to eligible concern
	i) Industrial concerns conforming to Sec.2© of IDBI Act. ii) Cost of projects should not exceed Rs.500 lakhs iii) Interest rate and other terms and conditions prescribed by eligible institution should be in conformity with the stipulations of IDBI iv) Should not be SSI
Nature of assistance	Rupee Loan

(xv) Bills Rediscounting Scheme

Objective	The scheme has been extended to cover or promote sale of indigeous machinery / equipment to commercial establishment of institutions.
Eligibility	The bills / promissory notes to be eligible for rediscounting by IDBI must be drawn by an industrial concern confirming to Sec.2© of IDBI Act.
Nature of assistance	Rupee

(xvi) Merchant Banking Services

- Project Apprisal
- Loan Syndication – rupee and foreign currency
- Issue Management – structuring, assisting in preparation of offer document, obtainig clearances, marketing and Post Issue activities.
- Underwriting of Issues and direct invsetments.
- Corporate councelling – acquistion, amalgamation and merger, Corporate restructing, short and long term investment plans.
- Assistance in raising money in overseas markets.

FOREX SERVICES	Forward cover Forex Dealing

4.3.1.3 Operations of the IDBI :

As stated earlier IDBI provides direct loans to industrial concerns, refinance of industrial loans refinance of exprt credit, rediscounting of bills underwriting of and direct subscription to shares and debentures of the industrial units and direct loans for exports. Since its establishment in 1969 till the end of March 1994 IDBI has sanctioned assistance of Rs.77164 crores and had disbursed Rs.55158 crores.

Direct Assistance:

Direct assistance of IDBI takes the form of project loans, underwriting and direcct subscription, guarantee for loans, etc. Over the years, there has been a steady increase in the direct industrial assistance of IDBI. Over 85 percent of the direct assistance was sanctioned to units in high priority industries such as basic industrial chemicals, cement, fertilisers, iron and steel electricity generation, sugar, textiles, paper and industrial machinery. IDBI has introduced new services with a view to provide wide range of services under direct finance for meeting specific requirements of its customers. For instance, IDBI has introduced venture capital fund and Technology upgradation. Equipment Finance, Asset Credit and Equipment Leesing. During 1993-94 IDBI sanctioned direct financial assisatance to the tune of crores for nearly 800 projects.

Assistance to backward areas:

With a view to promoting industrial development in backward areas. IDBI announced in July 1969 the outlines of a scheme for assistance to small and medium projects in such areas on softer terms such as concessional rates of interest, longer grace repayment periods, etc. Concession under this scheme would be generally available for projects where measures to encourage flow of institutional finance to the small-scale sector. The scheme was revised and liberalised later. Under the liberalised scheme, IDBI in participation with IFCI and ICICI gives concessional rupee assistance upto Rs. 2 crores and underwriting assistance upto Rs. 1 crore. IBI's concessional assistance and refinance of loans for backward areas have been steadily increasing in terms of the number of applications and the amounts sanctioned and utilised.

Refinance of Industrial Loans:

IDBI took over the Refinance Corporation of India in November 1964. and is providing refinance facilities to industrial units

through member banks. As as apex institution, IDBI assists the State Financial Corporations, ICICI and other are working in the field of industrial finance by subscribing to their shares and bonds. Since April 1966, IDBI has introduced a scheme for participation in loans and guarantees to supplement the refinance operations as a measure of risk-sharing with other institutions. Refinance of industrial loans sanctioned by IDBI since its inception up to March 1994 came to Rs...crores. With a view to stimulating the flow of credit to the export sector, IDBI has libralised its scheme for refinancing medium term credit. It has also expanded its scheme for their rediscounting of usance bills arising out of sales of indigenous machinery on deferred payment basis.

Assistance of Small-scale:

Units Since 1967, IDBI has been extending indirect assistance to small-scale sector including small road transport operators (to buy trucks, buses and jeeps) principally through its schemes of refinance of industrial loans and bills rediscounting. IDBI has been administering Small Industries Development Fund to promote, finance and develop small-scale industries. IDBI introduced single window scheme for grant of term loans and working capital assistance to new tiny and small-scale units.

IDBI had also launched the National Equity Fund Scheme in 1988 for providing support, in the nature of equity to tiny and small scale industrial units. The scheme is administered by IDBI through nationalised banks. IDBI has set up a Voluntary Executive Corps Cell (VECC) to utilise the service of experienced professional for counselling small units, tiny and cottage units and for providing consultancy support in specific areas.

The Government of India set up the Small Industries Development Bank of India (SIDBI) under SIDBI Act, 1989 as a wholly-owned subsidiary of IDBI SIDBI started functioning from April 1990 and has taken over the responsibility of administering Small Industries Development Fund and National Equity Fund which are formerly administered by IDBI, SIDBI has become the principal financial institutio for promotion, financing and development of small-scale industries. SIDBI is described laborately in the next section.

Balanced Regional Development:

Since 1970, IDBI has initiated certain promotional and development activities to meet the twin objectives of balanced regional development and accelerated growth. In co-operation with other term lending institutions, IDBI has completed industrial potential surveys in all States and Union Territories demarcated as backward. 389 project ideas have been identified and recommended for implementation in 13 States and 4 Union Territories. Out of the several project ideas, 74

NOTES

projects involving capital investment of Rs. 283 crores were implemented.

Soft Loan Scheme:

IDBI introduced in 1976 the soft loans scheme to provide financial assistance to productive units in selected industries, viz, cement, cotton, textiles, jute, sugar and certain engineering industries on concessional terms to modernise, replace and removate their plan and equipment so as to achieve higher and more economic levels of production. The scheme is administered by IDBI with financial participation by IFCI and ICICI. The basic criterion for assistance under the scheme is the weakness of the production units on account of obsolescence of machinery. Up to June 1977, 53 units were assisted under this scheme with a total amount of Rs.66 crores, but the place of disbursement was slow-only Rs. 20 crores for 33 companies. The soft loan scheme was not attractive to the private sector units because of the convertibility clause.

From January 1984, the Soft Loan Scheme was modified-now called Soft Loan Scheme for Modernisation-so as to cover deserving units in all industries. Under this scheme, production units can borrow from term lending institutions to finance modernisation, especially to upgrade technology, export orientation, import substitution, energy saving, prevention of pollution, recycling of wastes, etc.

Foreign currency requirements of industrial sector: IDBI raises foreign funds from international money markets and funding institutions to cater to the foreign currency requirements of the industrial units. As at the end of March 1990, total foreign currency borrowing of IDBI aggregated US $ 1.5 billio.

IDBI is providing resources support to financial intermediaries during 1992-93 amounting to Rs. 420 crores, IFCI, SFCs, leasing companies and other financial intermediaries were assisted by IDBI with loans and investment in their shares are bonds.

IDBI has been permitted by SEBI to carry out merchant banking activities which cover professionals and services to industry for raising unit, etc. The Merchant Banking Divisions of IDBI in the very first year (1992-93) was the lead manager of 35 issues and had raised nearly Rs. 4800 crores. Upto 31-3-1994; IDBI has managed 118 rights and public issues for mobilising Rs. 12,340 crores from capital market.

Check Your Progress
6. Soft loan scheme was introduced by IDBI in the year___.

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4.3.1.4 Restructuring the IDBI :

The IDBI had demonstrated its usefulness as an apex institution in the sphere of medium and long-term finance. The coordination of the operations of the term lending financial institutions on an active and systematic basis and the initiation of new facilities for industrial finance to meet the complex needs of industrialisation has made great progress under the leadership of IDBI. But some critics were dissatisfied with the working and achievements of IDBI. They felt that IDBI had failed to serve as an effective development bank and that it had not sufficiency accelerated the process of industrialisation in the country. According to them, the basic cause for this sad state of affairs was that the IDBI had not been an independent organisation but had been a subsidiary of the RBI. More specifically, ineffectiveness of the IDBI was due to:

(a) Its close association with RBI, both having a common board of directors.

(b) The Government and the Deputy Governors were incapable of shouldering the responsibility cast on them, and

(d) The management of the RBI and IDBI had made themselves of procedures.

The Government of India accepted these criticisms and through an Act of Parliament took over the ownership and management of IDBI. The entire share capital of the IDBI held by the Reserve Bank was transferred to the Central Government. The IDBI now has a separate board of directors, representing the Government, the banks, financial institutions and other interests. The table 4.1 explains the details of assistances sanctioned and disbursed by IDBI.

Table 4.1

The Assistance Sanctioned and Disbursed by IDBI

(Rs. In Crores)

S.no	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	16.98	12.59
2	1990-91	62.72	45.01
3	1991-92	65.10	57.82
4	1992-93	92.47	67.13
5	1993-94	120.86	80.96
6	1994-95	181.99	106.72
7	1995-96	164.76	106.95
8	1996-97	156.34	114.68
9	1997-98	239.82	151.70
10	1998-99	255.55	144.03
11	1999-2000	269.66	170.59
12	2000-01	268.32	174.59
13	2001-02	158.67	110.72
14	2002-03	58.98	66.14
15	2003-04	39.37	49.86
16	2004-05	107.99	61.83

4.3.2 Industrial Finance Corporation of India (IFCI) :

At the end of World War II, the urge for speedier industrial expansio was greate. At the same time, there was also great need for modernisation and replacement of obsolete machinery in already established industries. The usual agencies meant to provide finance for large-scale industries were either apathetic or were found inadequate

and hence the Government of India came forward and set up the Industrial Finace Corporation of India (IFCI) in July, 1984 under a Special Act.

4.3.2.1 Resources of IFCI :

The authorised share capital of IFCI was Rs.10 crores. Now it is Rs.20 crores. The shareholders of IFCI are the Industrial Development Bank of India (formally these shares were held by the Reserve Bank and the Central Government) and banking other financial institutions. The Union Government has Guaranteed the repayment of minimum annual dividend at 2.25%.

The Corporation is authorised to issue bonds and debentures in the open market within certain limits. It can borrow from RBI. The Corporation is also authorised to borrow foreign currency from the World Bank and the other organisations to grant loans to any concern which requires foreign currency. It can also accept deposits from the public for a minimum period of five years. Thus, the resources of the Corporation consist of its share capital and reserves public deposites, advances from RBI, the World Bank and other international agencies and bonds and debentures issued in the open market.

4.3.2.2 Functions of IFCI :

The Corporation performs three important functions. In the first place, it grants loans and advances to industrial concerns; it grants both rupee loans and foreign currency loans. Secondly, it guarantees loans raised by the industrial concern in the market. Thirdly, it underwrites the issue of stocks, shares, bonds, debentures of industrial concerns provided such stocks, shares, etc., are disposed of by the Corporation within a period of seven years from the time of acquistion. It also subscribes to the equity and preference shares and debentures of companies. In recent years, IFCI assists industrial units under the equipment leasing scheme.

The corporation is now permitted to subscribe directly to the shares of any concern. It can grant loans only to public limited companies. It does not complete with the commercial banks in financing industrial concerns but supplements their work by granting loans in such amount and for such periods as are outside the scope of ordinary commercial banks.

IFCI is authorised to give long and medium-term finance to public limited companies and co-operative societies engaged in manufacturing, mining, shipping, and generation and distribution of electricity. By an amendment to the Industrial Finance Corporation Act, private limited companies became eligible for finance Corporation Act, private limited companies became eligible for financial assistance from the corporation. The limit of assistance to any single concern is

now Rs.1 crore and under certain curcumstances, this limit can be exceeded with the permission of the Government. The period of loans is not to exceed 25 years. The lending rate is continuously revised. IFCI charges lower rates in case of projects in notified backward areas.

Before granting a loan to an industrial concern applying for financial aid, the Corporation scrutinises the application carefully and the following points are evaluated, viz., (a) the important of the industry to the national company, (b) the feasibility and the cost of the scheme for which financial aid is recured, (c) the competence of the management, (d) the nature of the security offered, (e) the adequacy of the supply of technical personnel and raw materials, and (f) the quality of the product and country's requirements of the product manufactured.

While lending, the Corporation requires the security of fixed assets such as land, buildings, plant and machinery and it does not normally lend against raw materials or finished products. It ordinarily requires the borrowing concern in order to ensure efficient management and also to safeguard the interest of the Corporation. In fact, the Corporation has the right to take over the management of a concern or to sell the property mortgaged in the event of continuous default in the payment of interest and of the principal advanced to the concern. It obtains periodic reports from borrowing concerns and also undertakes periodic inspection.

4.3.2.3 IFCI's services cover :

(i) Project Finance

(ii) Financial Service

(iii) Promotional Service

(i) Project Financing by IFCI :

Types of Projects:

IFCI provides direct financial assistance to the industrial projects in the corporate and co-operative sectors. The projects may be of the following types:

- New Project
- Expansion Project
- Diversification Project
- Modernisation Project

(ii) Financial Services :

Besides the traditional project financing, IFCI also provides various financial service. Thesr are

- Equipment Financing
- Equipment Leasing
- Equipment Procurement
- Equipment Credit
- Instalment Credit
- Suppliers Credit
- Buyer's Credit
- Finance to Leasing & Hire Purchase Concerns

(ii) (a) Merchant Banking :

The Merchant Banking Division of IFCI offers a wide variety of services in the wake of the growing needs and complexities involved in the establishment of medium and large industrial enterprises. Some of the important services are :

- Project Counselling
- Credit Syndication
- Issue Management
- Corporate counselling for financial reconstruction and rehabilitation of old, ailing or sick industrial units.
- Service to NIRs suitable investment opportunitiesin india.
- Assistance in the negotation of foreign collaboration.
- Technology finance and arrangements for risk / venture capital.

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(iii) Promotional Services :

The promotional activities of a development bank reflect the socio-economic environment in which it operates, as also the policies and priorities influencing its field of opeartions. A number of promotional services, being provided by IFCI as part of its development role, are in consonance with the measures aimed at implementation of the objectives of the government policies, and fit in well with overall institutional framework.

4.3.2.4 Infrastructure Institutions set up by IFCI :

Over the years, IFCI has identified several requirements of the financial infrastructure of the country and accordingly promoted specialised institutions to fulfill these requirements. Some of the important specialised institutions promoted by IFCI are:

(i) Technical Consultancy Organisations (TCOs) in Various States

The TCOs provide, under one roof, the total package. of consultancy services from 'concept' to commissioning of industrial projects, with a focus on tiny and small scale entrepreneurs.

(ii) Management Development Institute (MDI)

MDI provides training in modern management techniques to entreprenenurs and technologist entering industry, as well asto executives of enterprises. It also undertakes research in industrial and business management, development banking and related matters.

(iv) Risk Capital and Technology Finance Corporation Ltd (RCTC)

RCTC provides risk capital to the first generation entreprenenurs, and also financial for technology development, particularly for advancement, promotion, transfer, adaptation of technology. It also provides venture capital for potentially highly profitable ventures, involving innovative products/technology/services, aimed at futuristic or new markets.

Check Your Progress
7. MDI stands for

___________.

(v) Tourism Finance Corporation of India Ltd (TFCI)

TFCI provides finance to tourism and tourism related projects.

(vi) Rashtrya Gramin Vikas Nidhi (RGVN)

RGVN seeks to establish, promote support and develop voluntary organisations engaged in socio-economic upliftment of rural and urban poor, and orient them towards industrial pursuits.

(vii) Investment Information & Credit Rating Agency of India Ltd (ICRA)

ICRA primarily provides the credit rating, which guides investors/creditors in determinig risk associated with debt instruments/credit obligatons. ICRA ratings reflect independent, professional and impartial assessment of such instruments/obligations.

(viii) Institute of Laboyr Development (ILD)

ILD aims at providing training and retrainig facilities to workers, which inter alia, enables a better understanding of the Socio-economic problems and the workers responsibilities towards their enterprises and their rights and obligations as workers in industry.

(ix) Torism Advisory & Financial Services Corporationof India Ltd (TAFSIL)

The main objects of TAFSIL encompass, inter-alia, micro level project consultancy, building up of Data Bank preparation of project profiles to help new entreprenenurs, assisting State Governments in conducting tourism potential survey and drawing up master plans, etc.

4.3.2.5 Promotional Schemes :

IFCI has devised, as part of its promotional and developmental role, 14 schemes under which various subsidies are provided to entrepreneurs desiring to start industrial activity, paricularly in village, tiny and small scale sectors. These Promotional Schemes are:

Consultancy Fee Subsidy Schemes

(a) Scheme of subsidy to Small Entrepreneurs in the Rural, Cottage, Tiny and Small Scale Sectors for meeting Cost of Feassibility Studies, etc.

(b) Scheme of Subsidy for Consultancy to Industries relating to Animal Husbandrry, Dairy Farming, Poultry Farming and Fishing.

(c) Scheme of Subsidy for Consultancy of industries based on or related to Agriculture, Horticulture, Sericulture and Pisciculture.

(d) Scheme of Subsidy for Promotion Of Ancillary and Small Scale Industries.

(e) Scheme of Subsidy to New Entrepreneurs for meeting cost of Market Research/Surveys.

(f) Scheme of subsidy for providing Marketing Assistance to Small Scale Units.

(g) Scheme of Subsidy for Consultancy on Use of Non-conventional Sources of Energy and Energy Conservation Measures.

(h) Scheme of Subsidy for Control of Pollution in the village and Small Industries Sector.

Interest Subsiady Scheme:

(i) Scheme of Interest Subsidy for Self-Development of Unemployed Young Persons.

(j) Scheme of Interest Subsidy for encouraging Qyality Control Measures in Small Scale Sector.

(k) Scheme of Interest Subsidy for encouraging the Adoption of indigenous Technology.

Entrepreneurship Development Schemes:

(l) Scheme for encouraging Entrepreneurship Development Torism and Tourism related Activities.

(m) Scheme for encouraging Self-employement amongst persons rendered jobless due to retrenchment or rationalisation in a sick industrial unit in the organized sector undergoing a process of rehabilitation/revival.

Working of IFCI:

During the last 45 years, the monetary situation has been characterised by scarcity of funds relatively to the demand for them from trade, commerce and industry, particularly as regards long-term,

investment. On the one hand, the commercial banks have followed their usual cautions policy towards financing industries. On the other, the industrial concerns have not always found it easy to raise funds from the market for long-term requirement. Under these circumstances, IFCI has rendered considerable service to the Indian Industries.

The cumulative financial assistance sanctioned by IFCI since its inception in 1948 up to March 1994 aggregated Rs.19,294 crore against which disbursement amounted to Rs.12,545 crore. Among the many industries which have received financial assistance from the corporation are those which are of high national priority such as fertilizers, cement, power generation, paper, industrial machinery, etc. In recent years, IFCI has shown increasing concern over the development of backward districts-nearly 49 percent of IFCI sanctions were to assist projects in these districts.

Risk Capital Foundation:

In March 1972, the IFCI sponsored the Risk Capital Foundation (RCF) in order to provide assistance to new entrepreneurs including technologists and professionals from promoting industrial projects by giving loans free of interest or at nominal rates of interest: RCF was converted into Risk Capital and Technology Corporation Ltd. (RCTC) in January 1980. Apart from providing assistance in the form of risk capital, RCTC is providing technology finance, with special emphasis on:

(a) Provision of substantial innovative technologies, products, processes, market services, technological upgradation, energy conservation, etc.

(b) Meeting the expenditure of national and international consultants, and

(c) Sponsored commercial R & D programmes.

In the area of risk capital assistance, RCTC has so far sanction Rs.67 crores to nearly 250 projects (up to March 1994). These projects were based either on new technology or new usages. These included manufacture of anti-biotic drugs, radio paging systems, pay phones, calcium silicate bricks, granite and marble processing machinery etc.

Under its technology finance and development scheme, RCTC has so far sanctioned assistance of about Rs.10 crores for high risk technology projects such as development of artificial intelligence software for three-dimensional computer animation, software for local area network, digitized fonts, digitizers, educational robots, hybrid seeds, etc.

4.3.2.5 IFCI, Now Public Limited Company :

IFCI was originally incorporated under the IFC Act, 1948 but has been converted into a public limited company under the Companies Act, 1956 and has started functioning as such from July, 1993.

In recent years, IFCI has started new promotional schemes, such as

(a) Interest subsidy scheme for women entrepreneurs;

(b) Consultancy fee subsidy schemes for providing marketing assistance to small-scale units;

(c) Encouraging the modernisation in, small-scale and ancillary units and

(d) Control of pollution in the small and medium-scale units.

Since 1988-89, IFCI introduced two new schemes of financial assistance, viz., scheme for equipment leasing and a scheme for equipment procurement. Under the equipment Leasing Scheme, IFCI provides equipment (imported or idgenour) to the existing industrial concerns by of financial lease. Under the Equipment Procurement Schem, IFCI agrees to procure equipment and then to resell the same, by endorsement of documents, to the eligible existing industrial concern in the corporate or co-operative sectors.

IFCI is also diversifying its activities in the field of merchant banking to encompass other financial services, particularly project counselling, syndication of loans, formulation of rehabilitation programme, assignments relating to amalgamation and mergers, etc., Up to the end of March 1994 the Merchant Banking and Allied Services Department of IFCI has helped to mobilise funds of the order of Rs.3680 crores. The Table 4.2 explains the assistance sanctioned and disbursed by IFCI.

Table 4.2
The Assistance Sanctioned and Disbursed by IFCI

(Rs. in crores)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	2.07	1.09

2	1990-91	24.30	15.74
3	1991-92	24.21	16.04
4	1992-93	23.48	17.33
5	1993-94	37.46	21.63
6	1994-95	57.19	28.39
7	1995-96	103.00	45.63
8	1996-97	72.12	51.57
9	1997-98	76.93	56.50
10	1998-99	86.84	47.50
11	1999-2000	20.80	32.72
12	2000-01	17.66	21.56
13	2001-02	77.70	10.74
14	2002-03	19.60	17.79
15	2003-04	13.91	27.80

4.3.3 Industrial Reconstruction Bank of India (IRBI) :

In the recent years, several industrial units, particularly in the Eastern Region, were in severe difficulties and were on the verse of closing down. Lack of adequate demand, managerial incompetence, labour problems, shortage of raw materials, import restriction, etc., were some of the reasons responsible for this state of affairs. In view of their importance to the national economy and the needs of employment of large work force, these units had to be assisted financially. The Government of India set up the Industrial Reconstruction Corporation of India (IRCI) in April, 1971 under the Companies Act mainly to look after the special problems of 'sick' units and provide assistance for their speedy reconstruction and rehabilitation, if necessary, by undertaking the management of the units and developing infrastructural facilities like transport, marketing, etc. The IRCI had an authorised capital of Rs.25 crores, issued capital of Rs.10 crores and paid-up capital is Rs.2.5 crores. The Government of India had granted an interest-free loan of Rs.10 crores.

Check Your Progress
8. The Government of India set up the Industrial Reconstruction Corporation of India (IRCI) in the year

The management of IRCI is entructed to a Board of Directors, while its day-to-day administration os looked after by a Managing Director appointed by IDB. Since its inception in 1971 till the end of March 1984, IRCI had sanctioned reconstruction assistance of Rs.266 crores to 242 sick or closed industrial units; it had disbursed Rs.185 crores. Textiles, engineering, mining and foundry industries were assisted by IRCI. IRCI had paid special attention to the units located in the classified backward areas as also to those in the small scale sector. The corporation charged interest at 8.5 percent per annum, with the provision of concessional rates of 7.5 percent and 7 percent per annum to small-scale units located in the backward areas, respectively.

The Industrial Reconstruction Bank of India (IRBI) was established in 1985 under the IRBI Act, 1984 on reconstitution of the erstwhile Industrial Reconstruction of India as the principal credit and reconstruction agency to undertake reconstruction and rehabilitation to sivk and closed industrial units in the country. The scope of IRBI's financing activities has widened with the withdrawal of the Government stipulation that 60% of its portfolio should consist of sick companies; IRBI now finances projects like any other financial institutions.

IRBI extends loans and advances to industrial concerns, underwrites stocks, shares. bonds, debentures and provides guarantees for loans/deferred payments. It provides finance for acquisition of equipment and makes available machinery and other equipment on lease or hire purchase basis. It also provides infrastructure facilities, consultancy, managerial and merchant banking services. During 1993-94, as a part of its merchant banking services, IRBI ventured into issue management activities for the first time. It also took several steps to re-orient its business strategy in response to the emerging environment and on going changes in the financial sector by introducing newer products for financing. It has envisaged the setting up Special Fund viz., Reconstruction Assistance Fund to meet special financial needs of assisted medium and large scale units for their revival and rehabilitation which cannot be met from banks and financial institutions under normal conditions.

4.3.3.1 Schemes operated by IRBI :

(i) Term Loan Assistance. This includes

  (a) Short Term Loans

  (b) Bridge Loans

  (c) Short term working Capital Loan.

(ii) Asset Credit Scheme

(iii) Equipment Finance Scheme

(iv) Equipment Leasing Scheme

(v) Hier Purchase Scheme

(vi) Underwriting

(vii) Dorect subscription towards debentures

(viii) Deferred Payment Guarantee

(ix) Live of Credit Scheme (LOC) for Rehabilitation of sick small scale units.

4.3.4 Industrial Credit and Investment Corporation of India (ICICI)

The Industrial Credit and Investment Corporation of India was set up in 1955 and its issued capital has been up by Indian Banks, Insurance Companies and others, certain individuals and Corporations of the United States, the British eastern exchange banks and certain English and other Commonwealth insurance companies and other companies and the general public in India. The Corporation has been raising resources from within the country as well as from outside. It has obtained loans from the Government of India, the World Bank and from the Reconstruction Loan Corporation of West Germany.

The aim of the ICICI is to stimulate the promotion of new industries, to assist expansion and modernisation of existing one and to furnish technical and managerial aid so as to increase production and affored employment opportuinities. The Corporation grants (a) long-term or medium term loans (both rupee loans and foreign currency loans); (b) participates in equity capital and in debentures and underwrites new issue of shares and debenture, and (c) guarantees loans from other private investment sources.. Apart from the above direct finance, ICICI provides financial services such as deferred creidit, leasing credit, instalment sale, asset credit and venture capital.

The Corporation has so far assisted industries manufacturing paper, chemicals and pharmaceuticals, electrical equipment, textiles, sugar, metal ores, lime and cement works, glass manufacture, etc. In recent years, the Corporation has intensified its activities for assisting small-scale industries and industrial development of backward regions.

The Corporation has been playing a useful role in industrial finance. It assists industrial concerns with loans and guarantees for loans either in rupees or in any foreign currency. Besides, it underwrites ordinary and preference shares and debentures and it's also subscribes directly to ordinary and preference shares issues. A

Check Your Progress
9. The Industrial Credit and Investment Corporation of India was set up in the year _______.

significant role played by the Corporation is the provision of foreign curency loans and advances to enable Indian industrial concerns to secure essential capital goods from foreign countries.

ICICI commenced leasing operation in 1983 and provides leasing assistance for computerisation, modernisation/replacement, equipment for energy conservation, export orientation, pollution control, etc. The industries include under leasing are textiles, engineering, chemicals, fertilizers, cement, sugar, etc.

Under Project Finance, ICICI provides long-term rupee and foreign currency loans for different types of projects, loans for pollution control, energy conservation schemes and equipment finance. Financial services include merchant banking leasing and export development services. Under Technology Finance, ICICI offers assistance under the Progrm for advancement of commercial technology (PACT), the program for Acceleration of Commercial Energy Research (PACER), Agricultural Commercialisation and Enterprise (ACE) Programme and sponsored research and Development (SPREAD) Programme. Funds for the first three programmers have been provided by the United States Agency for International Development (USAID) whereas the World Bank has provided funds for the SPREAD programme.

USAID has provided a grant of US $ 25 million to ICICI to finance activities that aim at increaing environmental protection and enhancing productivity on a sustainable basis under the "Trade in Environmental Services and Technologies (TEST)" Programme, ICICI is the coordinating agency for implementation of the TEST Programme in India.

The Trade in Environmental Services and Technologies (TEST) programme has been specially formulated to address the above mentioned problems/constraints faced by the industry in India. USAID has provided funds of US $ 25 million for the TEST envisages providing loans, conditional grants and involvement of consultancy firms and exprts in the environment field.

Objetcives of the TEST Programme:

The objectives of the TEST programme are to improve environmental protection and productivity of Indian industry on a sustainable basis through linkages between Indian and US firms. The salient features of the programme are;

- Bridging the technology gaps in the area of pollution prevention and abatement; and
- Access to services and latest information available with specialised agencies and various databases.

Pacer Scheme:

The Industrial Credit and Investment Corporation of India Limited (ICICI) and the United States of America signed an agreement in August 1987 under which the United States Agency for Internation Development (USAID) is providing funds for supporting technology innovation and development in the Indian energy sector. This innovative scheme is called Programme for Acceleration of Commercial Energy Research (PACER) and ICICI has been entrusted with responsibility of executing it.

PACER is being implemented by ICICI under the overall direction of the Department of Non-Conventional Energy Sources (DNES) of the Ministry of Energy, Government of India. The Department has constituted Energy Research and Development Advisory Committee (ERDAC) to provide policy and procedural guidance for PACER approval of research and techhnology development proposals. ICICI has set up PACER SECRETARIAT at its Bombay office which deals with all operational aspects of PACER.

PACER aims at promoting development of goal-oriented and market responsive technological innovation in Indian energy sector through financial assistance to consortia of manufaturer (s) research institution(s) and/or end-user(s) from the public and private sectors in India. The technology development projects selected by the consortia are supported, where necessary, by competitive research disseminate information of relevance to technology developmnent and commercialization.

Pact scheme:

PACT is the outcome of an agreement between the Government of India and the United States of America signed in August 1985 under which the United States Agency for International Development (AID) is providing funds for the promotion and financing of Indo-US joint ventures in research and development (R&D). The Industrial Credit and Investment Corporation of India Limited (ICICI) is managing and administering the entire operations of PACT.

PACT is designed to accelerate the pace and quality of technical innovation for products and production processess having application in industry, agriculter health energy and other areas beneficial to the development process in India. This goal is being pursued by concentrating on development process in India. This goal is being pursued by concentrating on development process in concentrating on development of R&D capability in the private sector/joint sector to translate research already completed at the

laboratory stage into products and processess which succeed in the market. The focus of FACT is on the 'development end" of R&D which accounts for substantial cost, time and risk in carrying out commercially successful innovations. PACT's primary thrust is no market-oriented R&D activity aimed at India's technological advancement.

PACT envisages technology development (and not just technology transfer) through Indo-US joints venture in R&D. It is expected that such joint ventures bring in and introduce new technologies and processess from the US, as also provide the Indian partner an opportunity to acquire the US R&D management techniques.

The Agricultural Commercialisation and Enterprise Project (ACE):

The Agricultural Commercialisation and Enterprise (ACE) Project has been specifically formulated to improve investment environment for private agro business and aims at developing a dynamic and efficient post-farm agro business system. A fund of US $ 20 million from the United States Agency for International Development (USAID) with matching host-country contribution supports activities initially in the state of Maharashtra-to play a catalytic role and is being extended to other areas.

ACE Objectives:

- To increase private investement in the agro-business sector.
- To improve linkages between horticulture producers, processors, marketers and to increase far income; and
- To increase flow of fresh and proceed horticulture products to targeted domestic and export markets.

Eligible Organisation:

- Private commercial ventures and co-operatives.

Assistance:

Loans to private sector for agro-business activities:

- Innovative, i.e., introduction of a new product, process or market including new technology/equipment (imported from USA or available locally)

- Aiming at improvement in linkages between horticulture producers, processors and traders.
- Development of an integrated agro business by backward as well as forward integration and high value addition.
- Flexible to process various fruits/vegetables throughout the year. Non-dependence on a single product. Economic size of scale.
- Profit generating, self sustaining and environment friendly.

The Table 4.3 explains the financial assistance sanctioned and disbursed by ICICI.

Table 4.3

The Financial Assistance Sanctioned and Disbursed by ICICI (Rs. In crores)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	3.14	1.85
2	1990-91	37.44	19.68
3	1991-92	40.95	23.51
4	1992-93	57.72	33.15
5	1993-94	84.91	44.13
6	1994-95	145.28	68.79
7	1995-96	145.98	71.20
8	1996-97	140.84	111.81
9	1997-98	247.18	158.07
10	1998-99	342.20	192.25
11	1999-2000	435.22	258.83
12	2000-01	558.15	316.64
13	2001-02	362.29	258.31

4.3.5 Unit Trust of India (UTI) :

For some years, the Government of India was considering the establishment of an investment trust to extent facilities of investment in equity capital of companies by the large and growing number of small investors in the middle income group of the community. The Unit Trust of India was accordingly set up in February 1964. The initial capital of the Unit Trust was Rs.5 crores which was subscribed fully by the Reserve Bank of India (Rs.2.5 crores), the Life Insurance Corporation (Rs.75 lakhs), the State Bank of India (Rs.1 crore). The general superintendence, direction and management of the affairs and business of the trust are vested in a board of Trustees, consisting of a Chairman and nine other Trustees.

4.3.5.1 Objectives of the Unit Trust :

The promary objective of the Unit Trust is two fold: (a) stimulate and pool the savings of the middle and low income groups, and (b) to enable them to share the benefits and prosperity of the rapidly growing industrialization in the country.

These two fold objectives are achieved through a three fold approach:

i) By selling units of the Trust among as many investors as possible in the different parts of the country.

ii) By investing the sale proceeds of the units and also the initial capital fund of Rs.5 crores in industrial and corporate securities; and

iii) By paying dividends to those who have bought the units of the Trust.

4.3.5.2 Operations of the Unit Trust :

The Unit Trust had completed 30 years of operation in June 1994, the total number of applications in the first year was nearly 1,35,000 and the aggregate amount subscribed was about Rs.19 crores. After a sharp slump in the second year of its existence, the operations of the Unit Trust picked up conspicuously in the succeeding years. During 1974-75, however, there was a sharp decline and the sale of units came down to Rs.17 crores. This was mainly because of the hike in the deposit rates of banks. Savers found long-term bank deposits better than units. As a result, the sale of units picked up smartly. In the fface of stiff competition from banks for deposits and from convertible debentures, Unit Trust of India introduced many new kinds of units suitable for different savers.

The trust has built up a portfolio of investments which is balanced between the fixed income-bearing securities and variable income-bearing securities. The main objective of the Trust's investment policy is to secure maximum income consistent with safety of capital.

Investments in the corporate sector by way of equity and preference shares, debentures and special deposits etc, accounted for ovver 81 percent of the total investment of UTI (it was 67 percent a year ago). The Unit Trust has invested in securities of about 300 sound concerns. The bulk of the investible funds is invested in companies which are no regular dividend paying basis. Barring investment in bonds of public corporations, the Trust's funds have been invested in financial, public utility and manufacturing enterprises.

Other investments of UTI which account for 40 percent of the total investments of UTI are in the form of deposits with banks and in government securities.

4.3.5.3 Unit Trust and Pricing Policy:

The sale and repurchase prices of the units of Unit Trust are fixed according to rules framed by the Trust. The sale or the repurchase price is worked out in three stages. First, the basic value of the units is obtained by dividing the value of all the assets of the Trust less is current liabilities by the number of units deemed to be in issue. Secondly, certain nomal charges like brokerage, commision, stamp duties, etc. are added or deduted. Finally, the result is rounded to the nearest five paise.

In the repurchase price, charges are deducted for brokerage, commision, taxes, stamp duties and others relevant to the realisation of securities. The income element remains the same as in the case of selling price. The resulting price is rounded off to the nearest 5 paise upwards in the case of sale and downwards in the case of repurchase price.

With a large number of investments, the Trust goes on accounting income all the year round and this tends to taise prices continuously till the dividends are disbursed.

The difference of 5 percent between the sale and repurchase prices of the unit arises as a result of addition and subtraction of charges and the upward and downward rounding off of adjustments made to the basic price of units.

4.3.5.4 Advantages of the Units :

The units of the Trust having the following distinct advantages;

1. Investment in these units is safe, since the risk is spread over a wider range of securities (fixed income-bearing and variable income-bearing).

2. The unit holder's receiver a steady and decent income. Nine-tenths of its income is distributed.

3. Dividends upto Rs.4,000 distributed to unit holders, who are individuals, are exempted from income tax under section 80L of the I.T.Act along with certain other items of income.

4. Wealth-tax payers get benefit if part of their investments is in units.

5. The units are highly liquid in the sense that an investors can cash them whenever he wants. The units can be sold back to the Trust any time at prices fixed by the Trust. The units can also be transferred to third parties.

4.3.5.5 Schemes Introduced by UTI :

UTI introduced seven new schemes during the year. These included, besides the regular monthly income and deferred income unit plans and equity linked savings scheme, Children's College and Career Fund (CCCF) and growing corpus income Plan (GCGI).

During the year, UTI's wholly-owned subsidiary UTI Investors Services Ltd. Started functioning as register and Transfer Agency. UTI bank Ltd., commenced its operations from April 1994 and UTI Securities Exchange Ltd., a stock broking firm in July 1994. UTI also set up an independent social audit committee of five eminent citizens to study how far UTI has been able to fulfill its social responsibilities. The committee submited its report in October 1994, with effect from July 1, 1994, UTI's mutual fund operations have been bruoght under the preview of SEBI.

4.3.5.6 Assistance to Corporate Sector during 1989-2003 :

Assistance sanctioned and disbursed by UTI to corporate sector declined by 19.7% and 11.5% to Rs.8277 crores and Rs.6612.4 crores respectively during 1993-94. This was mainly on account of lower assistance by way of rupee loans and special deposits which recorded declines of 43.4% and 42.3% in sanctions and 38.4% and 40.2% in disbursements. However, assistance by way of underwriting/direct subscription, firm allotements and rights issues of shares/debentures/bonds recorded increased in both sanctions (13.8% to Rs.4817.1 crore) and disbursements (46.9% to Rs.3519.5 crore) during the year. The share of such assistance showed a significant increase to 58.2% in sanctions and 53.2% in disbursements from

41.1% and 32.1% in 1992-93. Cumulatively, up to end March 1994, assistance sanctioned and disbursed by UTI to corporate sector stood at Rs.3,19,764.8 crore and Rs.24,493.8 crore respectively.The amount of sanction and disbursement decreased from the year 2001-02.

Table 4.4
Assistance Sanctioned and Disbursed by UTI

(Rs. Crore)

Year	Sanctions	Disbursement
1989-90	120.8	1017.5
1990-91	2809.6	2441.2
1991-92	4320.5	3280.7
1992-93	10302.3	7469.4
1993-94	8277.0	6612.4
1994-95	7522.8	4791.2
1995-96	3685.7	3006.5
1996-97	3633.1	3237.3
1997-98	4532.8	3557.9
1998-99	3898.6	3435.9
1999-2000	6845.0	5162.1
2000-01	6770.1	4599.9
2001-02	991.0	1269.6
2002-03	307.4	414.7

4.3.5.11 An Assessment of the Unit Trust :

The commencement of the sale of units by the Unit Trust from July 1964 is acclaimed as a landmark in the development of India's capital market. In principle, the aim of the Unit Trust is praiseworthy since it seeks to mobilise the community's savings for investment in trade and industry. The Trust being public sector enterprises has created confidence among the general public. Besides, it has received a

number of tax concessions from the Government. Not only the capital is safe but it is highly liquid in the sense that any unit holder can return his units and get back cash from the Trust.

The operation of the Unit Trust in the last three decades or its existence has shown that the return for unit holders is responsible. For instance in the first year, The Trust was able to declare a maiden dividend of 7.62 percent per annum. The dividend rate has been gradually raised and it was 26 percent for the year 1993-94.

The Table 4.5 explains the details of financial assistance sanctioned and disbursed by UTI.

Table 4.5
The Financial Assistance Sanctioned and Disbursed by UTI

(Rs. Crore)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	0.40	0.51
2	1990-91	28.10	22.41
3	1991-92	38.14	29.06
4	1992-93	103.03	74.69
5	1993-94	83.33	66.12
6	1994-95	75.23	47.91
7	1995-96	36.86	30.07
8	1996-97	36.33	32.37
9	1997-98	45.33	35.58
10	1998-99	41.34	31.30
11	1999-2000	68.45	51.62
12	2000-01	67.70	45.99
13	2001-02	9.91	12.69
14	2002-03	3.07	

4.3.6 Life Insurance Corporation of India (LIC) :

4.3.6.1 Purpose and Structure :

The Life Insurance Corporation of India (LIC) came into being in 1956, as a statutory institution, set up under the life insurance Corporation Act of 1956, after the nationalisation of life insurance business in the country. Major reasons that led to nationalisation of insurance business were mobilisation of private enterprises. Gradually, the LIC has developed into a specialised all-India financial institution. It plays an important role in the capital market of the country and is, at present, the largest institutional investor. With a view to diversifying its assets and Government Securities, it maintains close contracts with other financial institutions, such as IDBI, IFC, ICICI and UTI for coordination of its investments.

4.3.6.2 Investment Policy of LIC :

The corporation is essentially in investment institution. Its investment policy has been designed after providing thoughtful consideration to cordial principles of safety of principal, diversification of investments in terms of types of securities, number and types of enterprises maturities and regions. The corporation is supposed to act on business principles and that its investment policy is guided by considerations of interests of its policy holders unless it be larger interests of the country.

The main tenets of the insurance policy of the insurance corporation are as under;

i) The keynote of the corporation's investment policy should be that the funds shall de invested in such manner as to safeguard and promote to the maximum extent possible, the interest of the policy holders. The larger interest of the country should not, however be ignored.

ii) Investments should be dispersed over different classes of securities industries and regions.

iii) The corporation should act purely as an investor and assume the role of an operator or speculator and try to take advantage of temporary fluctations in the market prices.

iv) The corporation should review its investment portfolio from time to time and make changes in its compositions as may be warranted under the circumstances.

v) The corporation would underwrite security issues after careful investigation of the proposals.

vi) The corporation would not acquire control or participate in mana The Industrial Credit and Investment Corporation of India was set up in 1955 gement of any concern in which it has interest as an investor unless exceptional circumstances warrant such participation,

The investment policy so enunicated is subject to reegulations by the provisions as contained in section 6 (i) of the Life Insurance Corporations Act, 1956 enjoining on it the duty of carrying on its business to the best advantage of the community and the primary obligation ohf holding the policy-holder's money in trust with the help of dynamic and vigorous management imbued with a spirit of trusteeship. The investment policy also clearly spelt ouy the need of investments on the long-term basis.

4.3.6.3 Investment Pattern of LIC :

The pattern of security investment of the corporation is gerned by section 27A of insurance Act, 1938. Accordingly, the corporation can invest in the following catagories of securities in the proportion started against each of cash category:

a) Central and State Govt. securities and

b) Other approved securities – Atleast 50% of the controlled units

c) Approved investments – Balance of controlled funds

d) Unapproved investments – Not exceeding 15% of the controlled fund.

4.3.6.4 Eligibility for Assistance :

The corporation invest only in securities, bonds, debentures or shares of public sector undertakings and public limited companies. It does not invest in private limited companies (vide Sec 27A of Insurance Act, 1938)

4.3.6.5 Types of Financial Assistance :
Direct Assistance to Industries:

The LIC subscribes to the capital of companies, both preference and equity and also to bonds and debentures. The Corporation also provides rupee loans with option to convert into equity. It also underwrites shares and debentures but it does not guarantee payments of deferred payments or loans as in the case of other financial institutions.

Assistance to other Financial Institutions:

The LIC is a shareholder in most of the financial institutions at both the Central and the State levels. It also subscribes to the boards of financial institutions including the State Financial Corporations.

4.3.6.6 Operations during 1989-2009:

Sanctions to corporate sector (excluding term loans to other Fis) rose by 88% to Rs.1464 crore during 1993-94. Assistance sanctioned by way of underwriting / direct subscribing increased by 63.1% to Rs.1298 crore in 1993-94 and constituted 78% of total assistance to corporate sector. Sanctions by way of term loans, however, declined by 43.5% to Rs. 166 crore accounting for 10% share in totalsanctions in 1993-94. Term loans sanctioned to other financial institutions during2008-09 aggregated Rs. 65008.9 crore as against Rs. 38454.3 crore in 2007-08.

Table 4.6
Assistance Sanctioned and Disbursed to Corporate Sector

(Rs. Crore)

Year	Sanctions	Disbursement
1989-90	578.0	455.0
1990-91	688.0	427.0
1991-92	1515.0	1022.0
1992-93	1740.0	1395.0
1993-94	1664.0	794.0
1994-95	1790.0	1343.3
1995-96	2341.9	2529.7
1996-97	2820.8	2760.6
1997-98	3472.6	3909.9
1998-99	4829.6	4824.9
1999-2000	6825.5	5634.3
2000-01	10867.2	7095.0

2001-02	6741.5	8914.2
2002-03	4332.7	6205.8
2003-04	21974.0	15781.6
2004-05	9339.9	7954.1
2005-06	15164.6	11199.5
2006-07	18126.9	27017.0
2007-08	3845435	27264.2
2008-09	65008.9	56434.4

Table 4.7
The Financial Assistance Sanctioned and Disbursed by LIC

(Rs. Crore)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	-	-
2	1990-91	6.88	4.27
3	1991-92	15.15	10.22
4	1992-93	17.40	13.95
5	1993-94	16.64	7.94
6	1994-95	17.90	13.43
7	1995-96	23.42	25.30
8	1996-97	28.21	29.61
9	1997-98	34.73	39.10
10	1998-99	48.30	48.25
11	1999-2000	68.26	56.34
12	2000-01	108.67	70.95

13	2001-02	67.42	89.14
14	2002-03	43.33	62.06
15	2003-04	219.74	157.82
16	2004-05	93.40	79.54
17	2005-06	151.65	112.0
18	2006-07	181.27	270.17
19	2007-08	384.55	272.64
20	2008-09	650.09	564.34

4.3.7 General Insurance Corporation of India (GIC) :

4.3.7.1 Objectives and Structures :

General Insurance Corporation of India (GIC) was formed on 22nd of November 1972, pursuant to the provision section 1971 of the General Insurance Business (Natonalisation) Act 1972, and has been registered as a private company is accordance with the provision of the Companies Act, 1956. It is also registered under section 3 of the Insurance Act 1938 for Transacting Fire Marine and Miscellaneous Insurance Business.

4.3.7.2 Functions :

General Insurance Corporation of India was formed for the purpose of superintending, controlling and if necessary carrying on the business of General Insurance and has been satutority charged with the following functions;

i) the carrying on of any part of the general insurance business if it thinks it desirable to do so;

ii) Aiding, assisting and advising the subsidiaries in setting up of standards, of conduct and sound practice in general insurance business and rendering efficient service to holders of politics of general insurance.

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iii) Advising the subsidiaries in controlling their expanses including the payment of commission and other expenses.

iv) Advising the subsidiaries in investment of their funds and

v) Issuing directions to subsidiaries in relation to the conduct of general insurance business.

4.3.7.3 Subsididaries :

General Insurance'Corporation of India has the following four subsidiaries, viz.,

1. National Insurance Company Ltd.,
2. New India Assurance Company Ltd.,
3. Orintal Fire & General Insurance Company Ltd.,
4. United India Insurance Company.

The Registered Office of the GIC is located at Bombay (Industrial Assurance Building, Church gate 4. Bombay 400020).

The GIC is managed by the Board of Directors of the Subsidiaries are appointed by the Chairman of the corporation after obtaining thr prior approval of the Central Government.

4.3.7.4 Nature of Business :

The subsidiaries carry on general insurance business, viz., Fire including consequential loss, Motor, Marine (hull and cargo) and Miscellaneous. The Miscellaneous Insurance Business includes worker's compensation insurance, Contractor's All Risk Insurance, Burglary Insurance, Personal Accident Insurance including Janata personal Accident policy: Engineering Insurance, Cattle Insurance and Agricultural Pumpsets Insurance. The Aviation Insurance and the Crop Insurance are under written by the Corporation. The Corporation has introduced a Pilot Crop Insurance Scheme in consultation with the Central Government which is being implemented in participation with the State Government.

Check Your Progress
10. __________ was formed for the purpose of superintending, controlling and if necessary carrying on the business of General Insurance.

All the subsidiaries are all-India organisations competing with one another in obtaining general insurrance business. The subsidiaries operate in many foreign countries directly and through their subsidiaries and associate companies. Their foreign operations are complemented by bilateral reinsurance trading with insures in almost every market of the world. In January 1978, the Corporation has set up an associate company called Loss Prevention Association of India Limited, with the objective of minimising and preventing accidental losses bby educating and offering various services to the insured and to the public.

Rural Insurance makes its contribution to the rural economy. The General Insurance Industry is actively cinsidering setting up a wide network of rural organisation eeconomic cost. It is felt that with the co-operaion of concerned agencies such as Regional Rural Banks, the co-operation movement and social agencies operaing in rural areas; it should be possible to take the message of insurance to all parts of the country during the next few years.

4.3.7.5 Forms of the financial assistance offered :

The GIC and its subsidiaries play a significant role in the capital market in the country. General Insurance Corporation and its subsidiaries subscrbe to and invest in the equity and preference shares and bonds and debentures of public limited companies. They also underwrite public issues of shares and debentures. In April 1976, the corporation joined the Institutional Meeting Forum, comprising of all-India financial insitutions viz., IDBI, IFCI, ICICI, LIC and UTI for granting term loans and other financial assistance to the industrial units. Such loans are sanctioned by the corporation and its subsidiaries along with other institutions.

4.3.7.6 Committee on Reforms in the Insurance Sector :

The Government had appointed a Committee of Reforms in the Insurance Sector. The committee which submitted its report to the Government in January 1994, has recommended major changes in the insurance industry. The main recommendations of the committee pertaining to GIC are that GIC and its subsidiaries should privatised eith Government retaining 50% stake in each of them; GIC should be restricted and should cease to be a holding company of its four subsidiary companies and should function exclusively as a reinsurance company; there should be stiff eligibility norms for private sector entry in insurance business and all insurance companies should be treated on equal footing; the minimum paid up capital for a new entrant should be Rs.100 crore; foreign insurance compnies should be allowed to conduct insurance business by floating joint venture Statutory Autonomous Board on the lines of SEBI should be established. The recommendations of the committee are under consideration of the Government.

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4.3.7.7 Assistance to Corporate Sector :

Aggregate assistance sanctioned by GIC and its subsidiaries during 1993-94 increased by 47.3% to Rs.824 crore; disbursement, however, declined by 12.3% to Rs.470.3 crore. Cumulative, up to end March 1994, sanctions aggregated Rs.3748.7 crore and disbursements amounted to Rs. 2506.9 crore.

Table 4.8
Assistance Sanctione and Disbursed to Corporate Sector

(Rs. In Crores)

Year	Sanctions	Growth Rate %	Disbursement	Growth Rate %
1989-90	211.2	72.3	179.6	55.6
1990-91	336.8	59.5	170.3	(-) 5.2
1991-92	695.5	106.5	280.1	64.5
1992-93	559.3	(-) 19.6	536.0	91.4
1993-94	824.0	47.3	470.3	(-) 12.3
Cumulative up to end March 1994	3748.7		2506.9	

Of the total assistance sanctioned to corporate during 1993-94, assistance by way of onderwriting / direct subscription to shares / debentures rose by 92.2% to Rs.669.2 crore accounting for 81.2% of the total. Sanctions of rupee loans declined by 26.7% to Rs. 154.8 crore reducing their share from 37.7% in 1992-93 to 18.8% in 1993-94.

4.3.7.8 Capital Structure of GICS :

GICS paid up share capiital as on 31.3.1994, stood at thhe Rs.375 crores. It had reserves and funds of Rs.5571 crores. The assets aggregated to Rs. 11,444 crores, including loans and advances of Rs. 1511 crores and investments in shares and debentures of Rs.5133 crores.

The table 4.31 explain the details of finance assistance santioned and disbursed bby GICS.

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Table 4.9
The Financial Assistance Sanctioned and Disbursed by GICs

(Rs. In Crores)

S.no	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	-	-
2	1990-91	3.37	1.70
3	1991-92	6.96	2.80
4	1992-93	5.59	5.36
5	1993-94	8.24	4.70
6	1994-95	6.89	3.79
7	1995-96	8.35	5.88
8	1996-97	12.73	9.25
9	1997-98	11.73	11.44
10	1998-99	13.15	13.86

4.3.8 Small Industries Development Bank of India (SIDBI) :

The Small Industries Development Bank of India (SIDBI) was set up the Government of India under a special Act of thhe Parliament in April 1990 as awholly-owned subsidiary of IDBI has taken over the outstanding portfolio of IDBI relating to small-scale sector worth over Rs.4000 crores. The authorised capital of SIDBI is Rs. 250 crores which could be increased to Rs.1000 crores.

4.3.8.1 Functions Of SIDBI :

SIDBI will be the principal financial innstitutions for promotion, financing and development of small-scale industries. It is also expected to coordinate the functions of existing institutions engaged in similar activities. Accordingly, SIDBI has taken over the responsibility of administering small industries Development Fund and National Equity Fund which were earlier administered by IDBI.

While extending financial assistance to the small-scale units scattered throughout the country. SIDBI makes use of the existing

Check Your Progress
11. The wholly-owned subsidiary of IDBI is _____.

institutions such as the SFCs, SIDCs, commercial banks, co-operative banks and RRBs, which have a vast network of branches all over the country. As many as 870 institutions are eligible for assistance from SIDBI.

The important functions of SIDBI as follows:

i) Refinancing of loans and advances extended by the primary lending institutions to small-scale industrial concerns and also providing resources support to them.

ii) Discounting and rediscounting of bills arising from sale of machinery to or manufactured by industrial units in the small-scale sector.

iii) Extension of seed capital / soft loan assistance under Naioal Equity Fund, Mahila Udyan Nidhi and Mahila Vikhas Nidhi and seed Capital Schemes through specified lending agencies.

iv) Granting direct assistance as well as refinancing of loans extende by primary lending institutions for financing export of products manufactured by industrial concerns in the small-scale sector.

v) Providing services like leassing, factoring, etc., to industrial concerns in the small-scale sector;

vi) Extending financial support to State Small Industries Developmetn Corporations for providing scarce raw materials and marketing the end products of industrial units in the small-scale sector.

vii) Providing financial support to National Small Industries Corporations for providing scarce raw materials and marketing support to industrial units in the small-scale sector

In setting up SIDBI, the intention of the Government of India was to ensure large flow of finacial and non-financial assistance to the small-scale sector. SIDBI has already initiated steps for technological upgradation and modernisation of existing units. It is expanding the channels for marketing the products of SSI sector in internal and international markets. It is promoting in a big way employment-oriented industries especially in semi-urban areas to create more employment opportuinities and there by checking migration of population to urban and metropolitan areas. During the first 4 in years of its existence 1990-94 SIDBI has sanctioned loans worth Rs.11517

crores and disbursed Rs.8683 crores. The bulk of SIDBI's assistance (nearly 71%) was in the form of refinance.

4.3.8.2 SCHEMES OPERATED BY SIDBI

	Lending Scheme	Purpose
I	**SHEMES OF REFINANCE ASSISTANCE**	
1)	General Scheme	For setting up new small Scale units or expansion, Modernisation, Diveisification, etc., of Existing units.
2)	**Schemes for cootage village & Tiny industries**	
a)	Composite Loan Scheme	Assistance for equipment and/or working capital as also for work seeds.
b)	Scheme for SC/ST and Physically Hanidcapped entreprneurs	Assistance for equipment and/or working capital.
3)	**Specific Schemes**	For acquisition of : a) In-house quality cotrol facilities. b) DG sets. c) Pollution contorl Eqiupment. d) Computers. e) For indegenisation / import substitution f) For manufacturing and installation of renewable energy / energy saving systems.

4)	**Equipment Refinance Scheme**	For identifiable items of Equipment / machinery of Diversification/ Modernisation/ Replacement/ self – fabricated equipment. Second hand machinery are not eligible.
5)	**Scheme for Small Road Transport Operators (SRTOs)**	To meet expenditure towards cost of chassis,body building, initial taxes/insurances and working capitals. Second hand vehicles are not eligible.
6)	**Scheme for Professionals**	For setting up for the first Time professionals Practice / consultancy Venture and of acquisition Additional equipments.
7)	**Schemes for Marketing activities**	
a)	Schemes for Marketing	For setting up new sales organisations outlets or undertaking renovation / expansion of existing outlets for marketing VSI products
b)	Scheme for Purchase of Mobile	For acquisition of new mobile sales Vans sales for stocking/display/sale of KVI products as also for transport of raw metarials for producing KVI products. Number of Vehicles not to exceed six Per borrower. Second Hand vehicles are not Eligible for assistance.
8)	**Schemes for Medical Profession**	
a)	Scheme for Hospitals/ Nursing Homes	For setting up small hospitals/nursing homes/ Poly clinics, etc., with 10

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		Or more but less than 50 Beds.
b)	Scheme for acquisition of Electro Medical and other	For acquisition and installation of electro Equipments medical and Other related equipment.
9)	**Schemes for Tourism and Related activities**	
a)	Schemes for Tourism and related activities	For setting up or development of amusement parks, cultural centers, convention centres, restaurents, tourist service agencies etc., including expansion and modernisation projects.
b)	Scheme for Hotel and Restaurent projects	For setting up of small hotels/restaurents in Urban/semi-urban areas.
10)	**Schemes for Infre-Structure Development**	
a)	Schemes for setting up of Industrial estates	For setting up of industrial estates for Exclusive allotment of Sheds/plot to SSI units.
b)	Schemes for Development, maintenance and Construction of Roads	For acquisition of capital goods/equipment required for the activity.
11)	**Equity-type Assistance Schemes**	
a)	Seed Capital Scheme	To meet the gap in prescribed minimum promoter's contribution or in equity.
b)	National Equity Fund Scheme	To meet gap in equity.
12)	**Schemes for Women**	
a)	Mahila Udyan Nidhi (MUN) Scheme	To meet gap in equity while setting up new industtrial projects in the small scale sector as also

		for service activities which are eligible for eligible for finance ass per SSSI norms.
b)	Scheme for Women Entrepreneurs	For setting up SSI units.
13)	**Special Scheme for assistance to Exiservicemen**	For setting up small industrial projects including service industries and transport activity which are eligible for finance as per SSI norms.
14)	**Single Window Scheme**	To provide both term loan for fixed assets and loan for working capital/cash credit facilities through the same agency.
II)	**BILLS SCHEMES**	
15)	**Bills Rediscounting Scheme (BRS)**	
a)	BRS (Equipment)	For sale acquisition of machinery on deferred payment terms for setting up of new SSI units as also for expansion, diversification modernisation, replacement,add-ition of balancing equipment etc.,
b)	BRS (Short Term)	To encourage bills cuulture as a method of working capital financing so as to ensure timely payment by large units. Trade bills arising out of supply of goods by SSI units and discounted with commercial banks either by the drawer (seller) or the drawee (buyer) are rediscounted by the banks with SIDBI

III SCHEMES OF DIRECT

1)	**Scheme for Specialised Marketing Agencies**	To set up new showrooms and/ or for renovation/expansion of existing showrooms and acquisition of sales vans for marketing products of SSI, cottage and village industries.
2)	**Scheme for Anciliary Sub-contracting units**	To implement expansion / modernisation/technology upgradation scheme covering need based additions/modifications to building, plant and machinery an margin money for working capital.
3)	**Scheme for Development of Industrial Areas for SSI sector**	For development of industrial areas with proper infrastructural facilities exclusively for SSI units.
4)	**Direct Discounting Schemes (DDS)**	
	a) DDS (Equipment)	To enable manufacturer-sellers in SSI sector/selling agents to offer Deferred payment terms for Credit sales and realise sale Proceeds by discounting bills of Exchange/promissory notes Arising out of such sales.
b)	DDS (Components)	To enable SSI units selling components. Parts, etc., to realise the sale proceeds quickly.

5) **Equipment Finance Scheme**

Objectives :

To assist the existing SSI units for acquisition of mabhinery / equipment. both indigenous and imported, which are not related to any specific project. This would facilitate modernisaiton/tecnology upgradation, expansion, diversification and quality improvement of existing well run units.

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Purpose :

Assistance under the scheme may be availed of for purchase of plant and machinery and other equipment including saving systems for modernisation/expansion/diversification/balancing scheme. The scheme could also cover additional need based civil works, miscellaneous fixed assets, additional margin monney for working capital, etc. Second-hand equipment will not be eligible for assistance under this scheme.

6. PROJECT FINANCE SCHEME

ELIGIBILITY NORMS

1. Type of Projects:

A) Existing units in the SSI sector with Health code 1 and 2 taking up

- ☐ Modernisation
- ☐ Tecnology Upgradatio
- ☐ Diversification
- ☐ Expansion

B) New SSI units

- ☐ Export oriented units
- ☐ Import substitutive units
- ☐ Hi-tech projects
- ☐ Projects promoted by well-established entrepreneurs

4.3.8.3 Technology Development & Modernisation Fund

Objectives :

To encourage existing industrial units in the small scale sector to modernise their production facilities and adopt improved and updated techology so as to strengthen their export capabilites.

Purpose of Assistance:

Assistance under the scheme would be available for meeting the expenditure on

a) Purchase of capital equipment. need based civil works & acquilisation of additional land.

b) Acquisition of technical know-how, designs, drawings and fashion forecast where relevant to specific product group.

c) Upgradation of process technology and products withh thrust on equality improvement comparable with acceptable domestic and international standards.

d) Improvement in packaging and

e) Cost of TQM and acquisition of ISO 9000 series certification.

4.3.8.4 Other schemes of Direct Assistance :

- Foreign Currency Loan for purchase of imported machinery.
- Preshipment Credit in foreign Currency for Expor-Oriented Units, Export Houses and Trading Houses.
- Short term loan to well-run SSI units execution of bulk order (eitther domestic or export)
- For acquisition of ISO-9000 series of certification.
- Venture Capital Fund.
- Equity Assistance to SSI projects.

4.3.8.5 Schemes Introduced:

During 1993-94, SIDBI took several new initiatives. It started extending foreign currency loans to export-oriented units for import of capital goods and introduced a scheme for grant of Rs.25,000 and financial assistance on soft terms to export oriented units with to get accredittation of ISO-9000 certificates. Through collaborative efforts DECTA (a British Government Agency for export development programms in India), SIDBI has started assisting SSIs with potential for exporting to Western Europe and North America; SIDBI has decided to make direct equity investment in public issues of SSIs to help them in accessing capital market; this is in addition to the lines of credit extended by SIDBI to merchant bankers for supporting the public issues of SSI units on OTCEI market. It introduced refinance facility in respect of small units engaged in floriculture activity and launched an integrated infrastructural development scheme jointly with Government of India. SIDBI also started offering support to Non-Govvernment organisations for creation and strengthening of self help potential of the rural poor, particularly women. During the year, SIDBI reduced interest rates on refinance and changed the interest rate structure for its direct finance, line pf credit and rates of discount / rediscount. The project outlay under Single Window Scheme was raised from Rs. 30 lakhs to Rs.50 lakhs; its scope also acquisition of idle fixed assets of sick units as also acquisition of idle fixed assets of sick units by new promoters/managements for assistance from primary lending institutions.

4.3.8.6 Operations during 1990-2008 :

Overall assistance sanctioned by SIDBI during 1993-94 aggregated Rs.3354.1 crore recording a growth of Rs.15.3% over the

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previous year. Disbursement went up by 24.5% to Rs.2671.3 crore. In addition, rediscounting of short term trade bills relating to small scale units amounted to Rs.660 crore as against Rs.641.5 crore in 1992-93.

Assistance sanctioned under project finance, refinance and bills finance in 2007-08 is expected to catalyst to catalyse aggregate investment of the order of Rs.29644.9 crore and create additional employment opportunities for 16.4 lakh persons in the small sector on completion of the assisted projects.

Table 4.10
Assistance Sanctioned and Disbursed

(Rs. In Crores)

Year	Sanctions	Disbursement
1990-91	2400.7	1838.5
1991-92	2846.0	2027.4
1992-93	2908.4	2145.8
1993-94	3354.1	2671.3
1994-95	4706.3	3389.8
1995-96	6065.6	4800.8
1996-97	6485.3	4584.7
1997-98	7484.2	5240.7
1998-99	8879.8	6285.2
1999-2000	10264.7	6441.4
2000-01	9025.5	5919.3
2001-02	10903.5	6789.4
2002-03	8246.3	4414.2
2003-04	9090.6	6187.8
2004-05	11974.8	9099.8
2005-06	11102.3	10255.4
2006-07	16146.3	15099.3
2007-08	29644.9	28293.1

4.3.8.7 Direct Assistance :

Total sanctions under equity type assistance viz., National Equity Fund, Seed Capital SEMFEX and Mahila Udyam Nidhi were Rs.6 crore in respect of 1267 beneficiaries.

4.3.8.8 Refinance Assistance:

Refinance assistance sanctioned by SIDBI during 1993-94 at Rs.1766.5 crore was lower by 12.8% as compared to the previous, year mainly on account of the lower availment bby banks due to comfortable liquidity position, organisational and operational problems faced by some SFCs as also a slowdown in their receipt of new investment proposals.

Of the total refinance assistance sanctioned during 1993-94, 35.7% was in respect of tiny projects. The number of such projects had a share of 89% in the total number of projects for which refinance was extended.

4.3.8.9 Bills Rediscounting :

Assistance sanctioned unnder bills rediscounting at Rs.205.6 crore was lower by 19% as compared to the previous year, while disbbursements declined by 19.3% to Rs. 146.3 crore.

4.3.8.10 Asset Quality :

Although RBI guidelines with regard to income recognition asset classification and provisioning are yet to be formally extended to SIDBI, it has already been complying with them. As at end-March 1994, 96.3% of SIDBI's assets were classified as standard,1.3% as sub-standard and 2.4% as doubtful.

4.3.8.11 Industry-wise Assistance :

The industries which accounted for a major portion of SIDBI's sanctions under project finance, refinance, bills rediscounting and direct discounting in 1993-94 were electricity generation (12.9%), textiles (10.2%), chemicals & chemical products (8.5%), electrical & electronic equipment (8.2%), machinery (8%) and services (16%).
The table 4.41 explains the details of assistance sanctioned and disbursed by SIDBI.

Table 4.11

The Financial Assistance Sanctioned and Disbursed by SIDBI

(Rs. In Crores)

S.no	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	-	-
2	1990-91	24.09	18.39
3	1991-92	28.46	20.27
4	1992-93	29.09	21.46
5	1993-94	33.56	26.46
6	1994-95	47.06	33.90
7	1995-96	60.66	48.01
8	1996-97	64.85	45.85
9	1997-98	74.84	52.40
10	1998-99	88.75	62.85
11	1999-2000	102.65	64.41
12	2000-01	90.26	59.19
13	2001-02	109.04	67.89
14	2002-03	82.46	44.14
15	2003-04	90.9	61.88
16	2004-05	119.75	91.00
17	2005-06	111.02	102.55
18	2006-07	161.46	150.99
19	2007-08	296.45	282.93

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4.3.9 Non-Banking Financial Instituions (NBFI)

4.3.9.1 Merchant Banking, Underwriting and Other Financial Service :

In the last two decades, the capital market in India has witnessed significant developments. The volume of capital market transactions has increased sharply; its functioning has been diversified. New financial institutions such as merchant banks, mutual funds and venture capital companies have come up and are quite active. New financial instruments, such as fully and partly convertible debentures, (FCDs and PCDs) commercial papers, CDs etc., have appeared. These reflect the growing diversification and a measure of sophistication of the financial services sector catering to the needs of growing capital and money markets. The volume of new issues is presently between Rs.15, 000 crores to Rs.20000 crores. The number of shareholders runs into several millions, indicating the growth of the cult of equity. Commercial banks which deal in the money market are entering the capital market through their merchant banks and mutual funds subsidiaries. They are going into leasing and venture finance also.

4.3.9.2 Merchant Banking :

From the organisational point of view, the new issue market (NIM) in India has become fairly developed but there are serious institutional lacunas. We know that NIM provides the triple function of origination, underwriting and distribution of securities. While the last two functions, viz., underwriting and distribution have been performed rather effeciently, there were no specialised agencies to perform the first functions, viz., the orgination of issues of capital. Organization is an important function of NIM. It provides thorough investigation and sound judgement of the issue proposals. The need for such specialised institutions were not felt for a long time for , to some extent, the DFI's which specialised in term lending to companies could evaluate the new issue proposals and underwrite them. But with the rapid growth of the corporate sector and the NIM in India the need for specialist agencies for organization of issue proposals was felt and to meet this proposal, merchant banking has come into existence.

Initally, commercial banks set up merchant banking divisions which later become separate merchant banking subsidiaries. A few merchant banks have been set uup by private financial service copanies in association with foreign banking companies and money market institutions and some have been set up by firms and individuals engaged in brokerage and financial advisory business.

Merchant banks in India manage and underwrite new issues, they undertake syndication of credit, and they advise corporate clients on fund raising and other financial aspects. Indian merchant banks do

Check Your Progress
12. FCD stands for ____.

not undertake banking business, viz., deposit banking, lending and foreign exchange services.

The merchant banks were subject to two types of authorities:

a) SEBI sought to authorise and regulate all merchant banks on issue of capital and portfolio management; and

b) RBI supervised those merchant banks which were subsidiaries or affiliatives of commercial banks. If the merchant banks were to raise deposits, they would have to be subject to the guidelines issued by RBI.

4.3.9.3 Recommendation of Narasimham Committee :

The Narasimham Committee sees considerable potential for the operation of merchant banks are emerging as financially strong and independent. The Committee would like the 'Govvernment to encourage the formation of joint ventures with well-ruputed international merchant and investment banks. The committee would like the merchant banks to have access, in course of time to the market for deposits and borrowed resources, subject to the observance of prudential norms specially tailored to the conduct of their business.

Merchant banking has been statutority brought under the regulatory framework of SEBI and have to be authorised by the latter. Merchant bankers have to adopt the stipulated capital adequacy norms abide by a code of conduct which specified a high degree of responsibility towarde in respect of pricing and premium fixation of issues and disclosures in the propectus of offer letters for issues of capital..

4.3.9.4 Mutual Funds :

In recent years, mutual funds are the most important among thhe newer capital institutions. Several public sector banks financial institutions have set up mutual funds on a tax-exempt basis virtually on the same footing as Unit Trust of India (UTI). Their main function is to mobilise the savings of the general public and invest them in stock market securities. Accordingly mutual funds have attracted strong investor support and have shown significant progress. The Government has now decided to throw the field open to thhe private sector and joint sector mutual funds.

At present SEBI has the authority to lay guidelines and supervise and regulate the working of mutual funds. The guidelines issued by SEBI relate to advertisements and disclosures and reporting requirements. The invetors have to be informed about the status of their investments in equity, debentures and government securities.

Check Your Progress

13. _____ has the power to regulate all merchant banks on issue of capital and portfolio management.

The Narasimham Committee has recommended the following points about mutual funds:

i) The creation of an appropriate regulatory framework to promote sound, orderly and competitve growth of muutual fund business.
ii) The creation of proper legal frame work to govern the setting and operation of mutual funds (the UTI is governed by special statue) and
iii) Equality of tretement between various mutual funds including UTI in the area of tax concessions.

4.3.9.5 Hire-Purchase Finance Institutions ;

Hire purchase finance companies help small transport operators, framers and professoinals to buy equipment on the basis of hire-purchase the goods thhemselves serve as security until the loan is fully cleared. At present, the hire purchase form of credit is provided by private hire purchase finance institutions commercial banks and State Financial Corpoations (SFCs). The last two mentioned institutions have entered this field only recentlt. The bulk of the hire-purchase credit goes to the road transport industry. According to a number of studies on the subject, there is considerable demand for hire-purchase credit and there is good scope bboth for the organized banking system and private hire-purchase agencies to enter the field. Important features of the hire-purchase financial institutions in India are :

a) They are better developed and organized in the southern region than in other areas.

b) There is a large number of individuals and partnerships in this field.

c) Many small hire-purchase agencies indulge in such undesirable practises as charging exorbitant rates of interest, forcible repossession of thhe vehicles financed, etc.

d) The demand for hire-purchase credit exceeds considerably the suppily of funds for the same.

The private hire-purchase companies are organisationally weak. A large number of them are too small in size and financially weak. It is neccssray to strengthen them, by setting up through amalgamations and mergers, large and strong units. Bigger units will be financially strong; they can be easily controlled and regulated and they will not resort to unfair practises as the small units normally do.
Towards this end the Banking Commission has made the following recommendations:

a) All hire-purchase finance units should compulsorily be licensed and the licensing authority should be given the power to revoke the licence in the case of unsatisfactory functioning and unhealthy practices.

b) The Government should prescribe permissible equity-dept ratio and liquidity ratio for the hire-purchase companies and they should be higher for smaller units and lower for biggr units. This will include small units to become larger through expansion or throughh merger.

c) The hire-purcahse finance agencies should be classified into approved and non-approved catagories and the approved agencies should be entitled to refinance facilities from the banking system and their lending operations should be covered under the Credit Guarantee Scheme.

d) The leading commercial banks may form a few hire-purchase finance companies or they may promote subsidiary hire-purchase finance companies. The Banking commission particularly favoured the idea of local commercial and urban co-operative banks to take more interest in the field of hire-purchase, since theyy are specially suited to extend hire-purchase credit which demands. personalised service because of their intimative knowledge of local conditions.

4.3.9.6 Leasing Companies :

Leasing companies, throuh very common in the western countries, is new to India. In the last five years, a large number of leasing companies have been set up in India; however, only a few are said to bbe doing well..

In a leasing business or arrangement the user of capital equipment (i.e., an invvesttor) does not buy the product himself but only buys the use it against payment on a monthhly rental to a leasing

company which owns the product. There are two types of leasing arrangements,viz., operating leasing and finance leasing.

In operating leasing, the producer of the capital equipment offers his product for lease. IBM is the most famous example of this kind of leasing. IBM lease its computers to users along with its technical services and also, if necessary, continuos replacement by updated equipment. Operaing leasing, is therefore, direct and there is no middleman.

In finance leasing also known as capital leasing there are three parties involved, viz., the producer of the capital equipment, the buyer of the capital equipment (who is the investor), and a leasing copany. Let us take a simple example to illustrate this triangular relationship. Suppose M/s ABC Textile Mills Ltd. Of Delhi would like to acquire 10 additiional looms costing Rs.1 crore to increase its production of cloth. However, M/s ABC Textile Mills are short of funds and would not like to block their limited fund in fixed capital assets. Lakshhmi textile Machinery Manufacturing Company is willing to supply 10 looms at total cost of Rs.1 crore but would like to be paid in full immediately (for they require funds for their continued operations). Now a leasing company, viz., M/s XYZ Leasing Company, enter into the pictures. Lakshmi Textile Machinery Manufacturing Company,viz., M/s XYZ Leasing Company will sell the looms to M/s XYZ Leasing company for cash and the latter will lease the looms to M/s ABC Textile Mills M/s XYZ Leasinng Company is the lessor; M/s ABC Textile Mills, who are the user investors are the lessee. The leasing agreement involves rental payment including amortisation, interest and a leasing contract fee. This is a financial arrangement and there are no technical obligations of the lessor towards thhe lessee (as in the case of operating leasing).

4.3.9.7 Benefits of Leasing :

Leasing has become an important alternative to equity financing. Till now, companies needing capital equiipment for expansion and diversificationeould go in for borrowed funds from the market or from banks or financial instituitons. Leasing is super or to buying capital equipment through borrowed funds, for the lessee has a higher borrowing capacity which he can use for other purposes. Compared to bank borrowing, leasing procurement percent finance and thereby helps the lessee to put his funds to other uses, sucha as development and marketing.

Secondary, although leasing is more expensive than simple outright purchase of equipment, it has the advantage that payments are made in easy installments out of the rturn from the investment.

Thirdly, leasing contract can be tailored according to the needs of the lessee such as adjusting the leasing period and so on,

Fourhtly, there is no risk for the lessee, as rising interes rates, rising costs or inflation will not alter the leasing terms.

Finally leasing has tax benefits as the rentals paid on leased equipment are accepted expenditure and are automatically deductible from gross income. If the investor buys the capital equipment, he will be allowed to deduct interest on loans and depreciation from his taxable income. In case of leasing he is allowed to detect the total rental payment.

Most leasing companies in India combine leasing with hire-purchase financing. Even though many leasing companies were set up in recent years, only a few have suceeded. Many leasing companies failed because they were undercapitalised and badly managed. Leasing However has proved a popular financing method for acquiring plant and machinery, especially by small and medium sized enterprises. Their growth is due to advantages of speed, informality and flexibility to suit individual needs.

4.3.9.8 The Narasimham Committee on Leasing and Hire-purchase Companies :

The narasimham committee has recognised the importance and growing role of leasing and hire-purchase companies in the financial intermediation process and has recommended that:

i) A minimum capital requirement should be stipulated;
ii) Prudential norms and guidelines in respect of conduct of business should be laid down and
iii) Supervision should be based on periodic returns by a unified supervisory authority.

4.4 Summary:

The real development of every country is purely depends upon the development of industrial establishment. The commercial banks and financial institution plays a vital role in promotion of industry by providing financial assistance in various forms.

4.5 Keywords used in the lesson

- ✓ Commercial banks and financial institutions
- ✓ Joint finance
- ✓ Forms of assistance

4.6 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e
Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets, Institutions and Services, 3/e, by
Bharati V. Pathak

4.7 Answer to check your progress question

1. July, 1, 1964
2. 3crores
3. Asset Credit Scheme
4. Short term loans
5. Ventrure Capital
6. 1976
7. Management Development Institute
8. 1971
9. 1955
10. General Insurance Corporation of India
11. SIDBI
12. Fully convertible debentures
13. SEBI

4.8 Model Questions

1. Discuss the role of IDBI in the economic development of a country.
2. Bring out the different forms of assistance by IDBI.
3. Listdown the Merchant Banking services for promoting an industry.
4. What is Soft Loan Scheme?
5. What are the different functions of IFCI?
6. What are the different types of projects specified by IFCI?
7. What are the objectives of TAFSIL?
8. What are the different schemes operated by IRBI?
9. What are the different functions of ICICI?
10. What are the objectives of UTI?
11. What are the different subsidiaries of GIC?
12. What are the different functions of SIDBI?
13. What are the different schemes operated by SIDBI?
14. Write a short note on Mutual funds.

UNIT – 5

WORKING OF STATE LEVEL INSTITUTIONS

1.1 Introduction
1.2 Unit Objective
1.3 Unit structure
1.3.1 State Financial Corporations (SFCs)
1.3.2 The Tamilnadu Industrial Investment Corporation Ltd. (TIIC)
1.3.3 The Tamilnadu Industrial Development Corporation Ltd. (TIDCO)
1.3.4 State Industries Promotion Corporation of Tamilnadu Ltd (SIPCOT)
1.3.5 Industrial and Technical Consultancy Organistion of Tamil Nadu (ITCOT)
5.3.6 Small Industries Development Corporation Limited (SIDCO)
1.4 Summary
1.5 Keywords used in the lesson
1.6 Further reading
1.7 Answer to check your progress question
1.8 Model Questions

5.1 Introduction:

The scope of assistance provided by the Industrial Finance Corporation of India is limited since it deals with large public limited companies and co-operative socities which are engaged inn manufacturing, mining, shipping and generation and distribution of electricity. But there are both small-scale and medium size industries which require financial assistance and for this purpose, the State Governments desired to set up State Financial Corporations.

5.2 Unit Objective:

- To identify the role of various state financial institutions for the promotion and development of an industry in Tamilnadu

- To analyse the performance of various state financial institutions

5.3.1 State Financial Corporations (SFCs)

The Government of India passed the State Financial Corporation Act in 1951 and made it applicable to tall the States except Jammu and Kashmir. All the states have set up such Corporations with the object of helping small, medium and cottage industries.

The authorised capital of State Corporation is fixed by the State Government within the minimum and maximum limits of Rs. 50 lakhs and Rs. 5 crores and is divided into shares of equal value which are taken by the respective State Governments, the Reserve Bank of India, schedules banks, investments trusts and private parties. The shares are guaranteed by the State Governments. A state financial corporation can raise additional funds through issue and sale of bonds and debentures, receive publc deposits, get refinance facilities from the Industrial Development Bank of India (IDBI) and borrow from the Reserve Bank of India. The management of the State Financial Corporation is similar to that of IFCI; it has a Board of Directors, a Managing Director and Executiove Committee. The corporation can open offices at different places withhin the state.

Functions of the State Financial Corporations:

All types of industrial concerns can get accommodation from a State Corporation and in this sense the scope of activties, of a State Corporation is wider than that of IFCI. A State Financial Corporation can –

a) guarantee loans raised by industrial concerns which are repayable within a period not exceeding 20 years and which are floated in the market;

b) Underwrite the issue of stocks, shares, bonds or debentures of industrial concerns.

c) Grant loans or advances to industrial concerns repayable within a period not exceeding 20 years and

d) Subscribe to debentures floated by industrial concerns.

A State Financial Corporation is however, prohibited from subscribing directly to the shares or stocks of any company having limited liability except for underwriting purposes and granting any loan or advance on the security of its own shares. Some SFCs act as agents for their respective State Governments for sanctioning and disbursing loans to small-scale industries.

Difference between the State Financial Corpoations anf IFCI

In many respects. IFCI and the State Finance Corpoations resemble one another but there are some important points of difference also. In the first pleae. the State Corporation has smaller amounts of share capital – between Rs.50 lakhs and Rs.5 crores. Secondly, the

State Corporations are permitted to allot 25 percent of their shares to private parties while IFCI is not. Thirdly, the maximum period for which a State Corporation can lend or guarantee loans or subscribe to debentures is fixed at 20 years while the limit for IFCI loan is 25 years. Finally, the maximum amount of assistance which can be granted by the State Corporations has been fixed at Rs.10 lakhs but the limit in the case of IFCI is Rs.1 crore which can be exceeded in certain cases with the permission of the Union Government.

There are at present 18 State Financial Corporation. During 1993-94 the loans and advances sanctioned by thhe SFCs were of the order of Rs.1910 crores as compared to Rs.2015 crores during the previous year. The total assistance extended by the SFCs between 1965 and 1994 came to Rs.16820 bulk of the assistance (over 70 percent) sanctioned / disbursed by the SFCs went to small-scale industries including road transport operators. Attempt is now being made to strengthen and improve the effectiveness of SFCs as regional development bbanks.

The State Financial Corporations (and SIDCs) sanction seed capital assistance under seed capital schemes introduced and operated by IDBI. This assistance is available to promoters of small business units. Since June 1989, SFCs have also been implementing special schemes of seed capital assistance to women entrepreneurs. Assistance is extended in the form of loan or grant of a combination of both to voluntary agencies working for women in decentralised industries. The table 5.1 explains the details of assistance extended by SFCs.

Table 5.1
The Financial Assistance Sanctioned and Disbursed by SFCs
(Rs. In crores)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	-	-
2	1990-91	18.64	12.71
3	1991-92	21.90	15.37
4	1992-93	20.15	15.57
5	1993-94	19.09	15.63
6	1994-95	27.02	18.81
7	1995-96	41.89	29.61
8	1996-97	35.55	27.83

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9	1997-98	51.20	31.48
10	1998-99	24.94	21.23

5.3.2 The Tamilnadu Industrial Investment Corporation ltd (TIIC) :

A FinanncialInstitution for the development of Industries:

TIIC was incorporated in 1949 as a company under the companies Act, to foster industrial develoment of Tamilnadu. It provides financial assistance to small scale and medium scale industries unit mainly for the creation of fixed assets.

(i) Types of Assistance :

TIIC offers long and medium term financial assistance in the following forms:

a) Term Loans

b) Term Loan and working capital assistance under the single/ window Scheme.

c) Lease financing for machinery / equipments.

d) Hire Purchase financing for machinery / equipments

e) Merchant Banking Services.

(ii) Eligible Activities :

Assistance is available to industrial concerns engaged in or proposing to engage in the following:

a) Manufacturing, processing or preservation of goods;

b) Mining including development of mines;

c) Generation of electricity or any form of energy including wind mills.

d) Setting up of nursing homes and purchase of electro medical equipments by doctors and as well as non-medical persons;

e) Maintenance, repair, testing, servicing of machinery or any types of vehicles, vessels, motor boats, trailors or tractors:

Check Your Progress
1.TIIC was incorporated in the year _______.

f) Assembling, repairing or packaging of articles with the aid of machinery or power;

g) Hotels/Motels/Restaurants.

h) Purchase of vehicles for materials/goods/transportation and for transport of passengers;

i) Facilities for fishermen for fishing and preservation of fish including cold storage.

j) Research and development of any process or product in relation to any of the industrial activities eligible for financial assistance from the Corporation;

k) Borewell rigs/road laying equipments/earth excavators;

l) Business enterprises set up by qualified professionals in management, accountancy, medicine. architecture, engineering etc.

(iii) Limit for financial assistance :

The Corporation can provide term loan assistance upto Rs.150 lakhs to private or public limited companies and to registered co-operative socities. In the case of proprietary or partnership concerns, this limit is restricted to Rs.90 lacs. In case of financing under leasing and hire purchase, the maximum limit of assistance is Rs.250 lacs and the minimum Rs.5.00 lacs.

(iv) Jurisdiction :

The Corporation can provide assistance to industrial concerns set up any where in Tamilnadu and the Union Territory of Pondicherry.

(v) Various schemes of the corporation for financial assistance :

a. General Scheme :

Under the general scheme, term loan assistance is provided for small and medium sclae units to set up new industries and also for expansion, modernisation and diversification of existing units.

Check Your Progress
2. The maximum limit of assistance provided by TIIC is __________.

b. Nursing Home Scheme :

The corporation provides assistance for construction of nursing homes and purchases of electromedical equipments in all areas including metropolitan/corporation areas with minimum bed strength of 20. Non-medical personnel are also eligible for assistance under this scheme.

c) Transport Scheme :

The corporation provides loans for purchase of Transport vehicles viz. delivery vans, Lorries, trailors, tempos etc., for transporting of goods. It also finances the purchase of autos, tourist taxis, pickup vans and passenger buses having route permits.

d) Generator Scheme :

Assistance is giving for installation of power generating units for a captive use of the industrial units.

e) Equipment Refinance Scheme (E.R.S) :

If an industrial unit is a well established with good working results and a high reputation and is in urgent need of funds for the purpose of equipments/machinery (indigenous or imported), term loans can be considered expeditiously under this scheme.

For eligibility, units should;

i) Have been in operation for atleast 4 years;

ii) Have earned profits and/or declared dividend on equity shares during the preceding two financial years, and

iii) Not be in default to any institution or Bank.

f) Hotel Scheme:

Financial assistance is considerable for setting up of hotels/motels/restaurants in order to promote tourism and also for expansion and renovation of the existing hotels.

g) Single Window Scheme :

All eligible small scale units including tiny units, whose project outlay is within Rs.50.00 lakhs would be eligible for

both term loan and working capital assistance under the scheme.

h) Ex-servicemen Scheme :

A special scheme is being operated in collaboration withh SIDBBI and Ex-servicemen Board. The total cost of the project under the scheme shall not exceed Rs.15.00 lakhs. Promoter's capital under the scheme shall range from 10% to 18.5% and soft loan upto 15% is considered. The applications shall be routed through the Ex-servicemen Board.

i) Hire Purchase Scheme :

The Corporation provides assistance upto a mximum of Rs.7.50 lakhs per project on soft terms to SSI units to establish facilities for testing and quality control.

j) Hire Purchase Scheme :

Existing and financially viable SSI/MSI units with good proven track record can avail HP for purchase of machinery equipments and route buses. New units floated by existing reputed group of companies will also be considered for assistance on case to case basis. Assistance shall range from a minimum of Rs.5.00 lakhs to a maximum of Rs.250.00 lakhs.

k) Lease Financing Scheme :

Existing and financially viable SSI/MS units with good proven financial track record and new units in deserving cases are eligible for financial assistance under the scheme. Assistance shall range from a minimum of Rs.5.00 lakhs to a maximum of Rs.250.00 lakhs.

l) Merchant Banking Division :

TIIC has drawn up plans to provide Merchant Banking Services for offering various other financial services, like syndication of Debt/Equity investments, underwriting of shares. Listing of securities in S.E.I., OTCEI., etc.,

vi. Subsidiary :

a) Area Subsidiary :

The Government of Tamilnadu has declared 82 taluks as backward taluks and 3.1 taluks as most backward taluks. The list of backward and most backward taluks is enclosed in Annexure II. All industrial projetcts in the 31 most backward

taluks are eligble for a 20% investment subsidy project to a maximum of Rs.20.00 lakhs. All industrial projects set up in the 82 backward taluks are eligible for a 15% investment subsidy subject to a maximum of Rs. 15.00 lakhs. In addition to the above a capital subsidy of 15% subject to a maximum of Rs.15.00 lakhs is extended to all industrial projects set up in industrial estates developed by SIPCOT, SIDCO, MEPZ, MMDA, directorate of industries and commerce and other Co-operative industrial estates recognised by the Government of Tamilnadu.

An industrial project, however, can not avail both area subsidy and as well as product subsidy.

b) Ineligible Industries :

The following types of power intensive industries under Small Scale Sector are not eligible for subsidy;

a) Iron and Steel Industry

b) Aluminium Smelting

c) Calcium Carbide etc.

The following resource based and power intensive industries inder Medium/Major industries are not eligible for subsidy;

a) Granite Polishing

b) Textile processing, Texturising and crimping etc

c) Cement, sugar, textiles, flour mills, edible oils and solvent extraction units, rice mills, mining/quarrying, distilleries, breweries and malt extraction.

d) Hotel projects with investment aboveRs.100 lakhs and those set up within the Corporation limits of Madras, Madurai and Coimbatore.

e) Ceramic manufacturing and

f) Power intensive industries as declared by TNEB.

Check Your Progress
3. __________ under Small Scale Sector is not eligible to receive subsidy from SFCs.

c. Locational Policy Restrictions :

Normally state capital subsidy for backward areas is not available for medium / large industries wiithin 50 KMs radius of Madras city limits, 15 KM radius of Madurai and

Coimbatore City limits or within the Municiple limits of other Municipalities / Municipal Townships. The above locational policy restrictions will not be applicable to industries set up in industrial estates promoted by Government bby Government Agencies including SIDCO, MMDA, MEPZ. SIPCOT complexes, recogised Co-operative industrial estates, estates promoted by Directorate of Industries and commerce even if they fall within the 50 KMs radius of Madras and 15 KMs of Madurai and Coimbatore. The above locational policy restrictions will not apply to SSI unnits.

i) Electronic Industries :

All Electronic units are eligible for special subsidy of 20% subject to a celling of Rs.35.00 lakhs.

ii) Leather Industries :

All leather uunits are eligible for a special subsidy of 20% subject to a maximum of Rs.20.00 lakhs.

iii) Special Subsidy for Selected Industries :

Medium and Major Industries:

A special subsidy of 10% on fixed assets and subject to a maximum of Rs.15.00 lacs will be avvailable to medium and major industries for following selected catagories of thrust industries set up anywhere in TamilNadu.

i) Automobile spare parts;

ii) Drugs and Pharmaceuticals;

iii) Solar energy equipments and other non conventional energy devices;

iv) Export oriented gold jewellery making and diamond proceesing units.

v) Pollution Control equipments;

vi) Jute industry in 6 selected taluks: viz. Ambasamudram (Nellai Kattabomman District). Madurai (Madurai district). Musri (Trichy District). Kumbakonam (Thanjavur District). Panruti (South Arcot Vallalar District) and Chengalpattu (Chengal MGR District)

vii) Sports.goods and accessories:

NOTES

viii) Food Processing Industry and

ix) Cost effective building materials like aluminimum or PVC doors and windows, window frames, etc.

If the above selected catagories of thrust industries fall under SSI limit, they are eligible for a higher special subsidy at 20% subject to a maximum of Rs.15.00 lakhs set up anywhere in Tamilnadu.

IV. Tourism Projects :

New tourism projects in the following catagories will be extended a capital subsidy of 10% of the total investment (excluding cost of land) subject to a maximum of Rs.10.00 lacs per project.

a) One star, two three star hotels with investment less than Rs.100 lacs to be set up in Tamilnadu, excluding the Corporation limits of Madras, Coimbatore and Madurai.

b) Amusement Parks.

c) Approved Tour operators (For A/c coachers);

d) Gold Courses:

e) Restaurants approved by government of india/Govt. of Tamilnadu.

v. Generator Subsidy :

New generators purchased for captive use will be granted subsidy of 15% with a monetary ceiling of Rs.5 lacs. This subsidy wiil be available to extending industries irrespective of their location. This generator subsidy will not be available for conventional resource based industries and power intensive industrial units.

Check Your Progress

4. ____________ will not be available for conventional resource based industries and power intensive industrial units.

vi. Special subsidy for Effluent Treatment Plants :

A special subsidy of 10% subject to a monetary ceiling of Rs.2.00 lacs will be available for efflent treatment plants by the existing industries.

Subsidy for Employing Women Workers:

New industrial units which employ women workers more than 30% of their total workers' strength are eligible for additional capital subsidy of 5% of investment in fixed assets subject to a ceiling of Rs.5.00 lacs. This subsidy is available to all small/medium/major industrial units of their location. This subsidy will not be available for following industries: 1) Matches 2) Garments 3) Leather Goods 4) Hosiery and 5) Food Processing.

vii. Sales Tax Concession :

a) New Units :

New small/medium/major industries set up in 31 notifiied most industrially backward taluks. SIPCOT industrial complexes at Pudukottai, Manamadurai and Tuticorin and Dr. Vikram Sarabai Estate and Electronic city at Sholinganallur in Chennai MGR District are eligble for full waiver of sales tax dues for a period of five years up to the ceiling of total investment made in fixed assets. Alternatively, the industrial units can avail deferral of sales tax payment for 9 years to the full extent of total investment made in fixed assets.

New small, medium and major industries set up in 82 notified industrially backward taluks, other industrial estates promoted by SIDCO, SIPCOT, MMDA, MEPZ and Co-operative Indstrial Estates promoted by Directorate of Industries are eligible for deferral of sales tax for 9 years to the full extent of total investment made in fixed assets.

New units set up in other areas other than mentioned above will be eligible for deferral of sales tax for five years subject to a maximum of 60% of the total investment made in fixed assets.

b) Expansion / Diversification :

Existing industries undertaking expansion/diversification in the most backward taluks are eligible for full waivers of sales tax which is considered for a period of five years of deferral upto 9 years subject to ceiling of additional investment under expansion / diversification

Existing units located in industrially backward taluks and in estates developed by Government agencies including MEPZ, MMDA, Co-operative industrial estates promoted by Directorate of industries are eligible for deferrable of sales tax for 9 years and the total amount thus shall not exceed 80% of the additional investment made in fixed assets.

Existing units located in "other areas" will be eligible for deferral of sales tax for five years upto 50% of additional investment in fixed assets made in the case of expansion / diversification of the existing industries.

c) Tourism Projects :

Deferral of sales tax for a period of five years on restaurant sales is given to eligible hotels and restaurants i.e., one star, two star and three star hotels with an investment of less than Rs.100 lacs to be set up in Tamilnadu excluding the Corporation limits of Madras. Coimbatore and Madurai and restaurants approved by the Government of India and Governments of Tamilnadu.

Steps for setting up an industry :

a) Selection of Product :

i) Selection of product/industry.

ii) Chief Information Officer (Technical Information), Guindy. Madras – 32.

iii) Industrial and Technical Consultancy Organisation of Tamilnadu Limited (ITCOT) Madras-6

iv) Tamilnadu Small Industries Development Corporation Limited (SIDCO). Madras.

v) Tamilnadu Small Industries Service Istitute (SISI), Guindy, Madras – 32.

b) Approvals :

i) The Provisional Resgistration Certificate Should be obtained by SSI units from the District Industries Centre of the concerned district. In case of medium scale/ large scale uunits SIA registration small be done. If the product falls under compulsory licence, the small shall be obtained if the project involves foreign currency for importing capital goods. steps should be taken to obtain an import llicence, as necessary.

ii) Land and Industrial shed : If the site where the industry is to be set up is an agricultural land. it has to be re-classified for non-agriculture use. To get this done. the Town Planning Officer. the Tahsildar and the deputy Commissioner or the Assistant Commissioner should be approached.

iii) For allotment of a shed in an industrial estate, the entrepreneur has to approach SIDCO or SIPCOT.

c) **Building :**

The plan of the proposed building must be approved by

i) The local administrative authority such as the village Panchayat, the Municipality, the City Corporation, MMDA, etc as applicable.

ii) The Inspector of Factories.

iii) SIPCOT/SIDCO if the developed plot has been alloted with their industrial estate.

iv) If the unit to be located in any hill area like Nilgiris, Yercaud, Kodaikanal, etc., special permission has to be sought form the Government of Tamilnadu.

d) Power :

An application for the required power supply should be made to the Executive Engineer, Tamilnadu State Electricity Board.

e) Registration of Industry :

The entrepreneurs may have to register the industry with any of the authorities listed below as applicable:

i) Commissioner of Commercial taxex

ii) Regional Provident Fund Commissioner

iii) Collector, Centarl Excise

iv) Secretarist of Industrial Approvals (SIA). New Delhi (in respect of medium and large scale industries)

v) Drug Contrller (Pharmaceutical concerns)

vi) Director of plant protection, Central Control and Insecticide Cell, Faridabad (for pesticide manufacturing concerns)

vii) Director, Food and Vegetable Products (for fruit processing concerns)

viii) Tamilnadu Pollution Control board (For Pollution Clearance)

5.3.3 Tamil Nadu Industrial Development Corporation Ltd (TIDCO) :

Tidco's History :

Tamil Nadu Industrial Development Corporation Ltd. (TIDCO), a wholly owned Government of Tamil Nadu Enterprises, has been in the forefront of industrial expansion in the State. It was set up in 1965 to promote large and medium industries with investments exceeding Rs.50 millions in the public and private sectors. Oger the years, it has moved away from new public sector investments and presently focuses on equity partnership with the private sector. TIDCO has been functioning as a promotional agency. It assists in scouting for new opportunities, tying up technology and firming up project finance. It also assists in identifying land, securing water and power and stautory clearances.

TIDCO has been an equity partner of new industries. Its joint sector policy was introduced in 1970 with TIDCO contributing 26% of the total equity. Day-to-day management functions are left to the private sector partner. The Birlas, the M.A.Chidambaram Group, the Tatas, UB, etc. are some of TIDCO's joint sector collaborators.

From 1988 the concept of the associate Sector was introduced where TIDCO contributes 11% to the total equity. The organisation had also started disinvesting its equity from enterprises that had done well, with the first choice being given to the private partner. This has enabled TIDCO to participate in a larger number of new ventures and has at the same time, been consistent with the objective of allowing the private sector to grow independently in the market after some initial support. Some of TIDCO's associate sector partners are the J.K.Group, McnNally Bharat, Siemens, Lakshmi Machine Works, and Kaveri Engineering.

Recently, in 1992, TIDCO introduced an Excort Sector Scheme where a small 1% equity is offered to private enterprise locating in Tamil Nadu.

TIDCO's equity partners have included large industrial houses as well as first generation technnocrat entrepreneurs. Thus the organisation has experience in dealing with partners of varying market size and power. For example, TIDCO has promoted manufacture of watches in association with thhe Tatas (TITAN industries Ltd) and aluminium fluroide entrpreneurs like the Malladid and Pharmaceuticals Ltd., and Saptarishii Agro Industries Ltd.

Check Your Progress
5. TIDCO stands for
____

TIDCO's portfolio's is divversified. Its investments include basic goods such as cement, steel, fertiliser, as well as consumer products like shoes, watches and television sets. The entertainment industry has also been penetrated through the promotion of a theme park near madras. Very recently, TIDCO has begun to invest in the field of agribusiness, cloriculture, mushroom cultivation, etc. at present TIDCO is also invoived in promoting large infrastructure projects like integrated ignite mining and power generation at Jayamkondan in Trichy district.

As of March 1994, TIDCO has promoted 34 joint sector companies, 25 Associate Sector companies, I Escort Sector Company and 4 Public-sector Enterprises. A cumulative amount of Rs.1127 million has been given to TIDCO up to March 1994 bby the state Government. TIDCO made a net profit of Rs.34 million and paid a dividend of Rs.10 million to the Government of Tamil Nadu during year ended 31.3.93.

TIDCO's Equtiy Schemes:

TIDCO participates in the equity of new ventures in Tamil Nadu in order to promote invetments in the State and reduce risk perceptions of private entrepreneurs. Other three equity schemes are:

The Joint Sector:	TIDCO priovides for 26% of the equity share capital with the private promoter's of 25%. equal participation by TIDCO and private promoter on the Board of Directors is ensured. The Chairman is appointed by TIDCO.
The Associate sector:	TIDCO equtiy participation is upto 11% and the private promoter's equity is a minimum of 40%.TIDCO has only one nominee on the board. The Chairman is appointed by the private promoter.
The Escort sector:	TIDCO plays a guiding role contribution only 1% of the equity. TIDCO does not have representation on the board.

This apart in individual cases the equity structure can be tailored to suit specific needs, thus allowing sample flexibility.

Under all the three schemes,TIDCO and the private promoters together hold not less than 51% of the total equity. The balance can be raised from the public.

Since TIDCO promotes medium and large scale ventures, the minimum capital outlay for a project eligible for TIDCO assistance should be Rs.50 million.

TIDCO's professiional Expertise and service:

TIDCO has a distinguished Board of Directors who are experienced and senior officers of the State Government. It has a team of professional managers drawn from the fields of engineering, finance and law. This in-house expertise helps the organisation identify new projects; undertake project evaluation and feasibility studies to support viable project opportuinities.

Apart from equity support TIDCO assists in obtaining land, water and power for its projects. It also helps obbtainn the required stautory clearances. Assistances in firming up project finance form state and central lending agencies and banks is also given. This organisation's global connections are an advantage in sourcing and transfers have been arranged from the USA, Japan, Germany, France, Swedan, Switcherland, Spain and Finland.

After commissioning TIDCO provides further assistance to help stabilise the venture and guiding the promoter to reach a profitable level of operations. Once projects are successfully established, TIDCO disinvests in order to recycle its funds. The private promoter is given the first option to buy TIDCO's interests.

TIDCO's professional skills acquired over near three decades to handle a wide range of projects, its familiarity with local conditions and the commitment of its dedicated manpower help at every stage from concept to completion of projets.

TIDCO's Global connections:

TIDCO helps its business partners inn comprehensively planning their future development by accessing technology from the best sources any where in the world.

With the increasing need for quality consciousness, TIDCO srives to keep pace with the ever changing international technological and market demands.

Many of TIDCO's partners have collaborates with mulinational corporations from USA, Japan, UK, Germany, Finance and Italy.

Exploring New Frontiers:

a) Agri Business:

Projects in floriculture, mushroom prawnculture and egg processing are being promoted bby TIDCO. These are areas where Tamil Nadu has a comperative advantage.

b) Power Generation;

An integrated lignite mining and power generation project has been approved for private investment in the power sector. Siemens of Germany and McNally Bharat Engineering Company Limited have entered into a agreement with TIDCO. The project will be situated at Jayamkondan in Thiruchirapalli District under the Associate Sector. Rich in linite deposits, jayamkondan has been identified as an ideal place for the setting up of a captive mining and power generation plant. The total cost of this project is around Rs.7400 crores

c) Madras Industrial Park:

The Madras Industrial Park project has been conceptualised as a complex with world class industrial infrastructure facilities together with quality social infrastructure like housing, schools, health and recreational facilities, parks, etc. apart from developed sites, pre-built industrial buildings would also be available. Convention centers, computer networking and telecom facilities are alos planned.

The aim is to attract foreign investment into Tamil Nadu. The industrial park will be owned, developed and managed by a company, the Madras industrial park Limited, with private partners from India and Singapore. The project is proposed to come up in the Associate Sector. About 800 acres of land in sholinganallur, 20 kms from the city of Madras, have been identified for the project.

d) Other Areas:

Problems regarding availability of water for industrial use resulted in TIDCO exploring the possibility to jointly setting up a plant for desalination of sea water with a private partner. The process of reverse osmosis has been identified.

TIDCO plans to expend its activities by entering into financial services, like lease financing, mutual funds, etc.

Future Plans:

In a liberalizing economy TIDCO's investments will be increasingly guided by three priciples.

First, as a promotional agency TIDCO's will be a minority role in new ventures to that a majority of the funding as well as leadership and management resposibility lie in private hands. Hence the increasing focuses on the Associate Sector.

Second, TIDCO's investment would be an additionally to supplement private capital in its efforts to upgrade technology and product quality in order to enable Indian products to complete in

international markets. The example of TIDCO's recently promoted mushroom cultivation venture with Dutch equity and technology for export is a case in point.

Third, TIDCO would be ready to share project risks in areas newly opened up to the private sector requiring bulky investment and involving long gestations lags. For example a venture to mine lignite and generate power is low under way with siemens and other German Multinationals.

Other State Promotional Agencies in Tamilnadu:

The state government has five promotional agencies, apart from TIDCO for the active promotion of industrialisation in Tamil Nadu.

GUIDANCE (The Tamil Nadu Industrial Guidance & Export Promotion Bureau) is a registered society set up recently by the Government of Tamil Nadu to render escort services to prospective entrepreneurs. Its objectives are to provide information & guidance regarding scope, incentives, facilities and procedures for statring industries in Tamil Nadu. Besides assistance in otaining speedy clearance, it also disseminates information relevant to industry through its database. It is entrusted with a wide range of funictions which include guidance for exploration of foreign markets, collaborations and search for technology upgradation, facilitating NRI investments, feedback to the Government on its policies, the conduct of evaluation studies etc.

SIPCOT (State Industrialies Promotion Corporation of Tamil Nadu Ltd) plays a promotional role in the acceleration of industrial growth in Tamil Nadu by providing financial assistance to medium and large industries through term loans and subsidies.

ELCOT (The Electronics Corporation of Tamil Nadu Ltd) promotes public and joint sector units in the electronics industry. It has various schemes of equity participation investors and is currently involved in setting up an Electronics City near Madras.

TACID (Tamil Nadu Corporation for Industrial and Infrastructures Development Ltd) has been constituted to provide infrastructural facilities. Thhis is an exclusive agency concentrating solely on development of appropriate infrastructure in industrial areas. This corporation is involved in the establishment of new growth centres. TACID also provides for soft infrastructure, such as hospitals, schools etc. in areas to be newly industrialised.

TAMIN (Tamil Nadu Minerals Ltd) is engaged in the exploitation of a wide range of minerals. It has a team of well trained and experienced geologists, mining personnel and executives. TAMIN

now undertakes projects with equity participation from the private sector.

Services of these agencies are available to all investors, both within and from outside Tamilnadu.

5.3.4 States Industrial Develpoment Corporations (including SIPCOT)

The State Industrial Developent Corporation (SIDCs) was established under the Companies Act, 1956, in the sixties and seveties as wholly-owned State Government undertakings for promotion and development of medium and large industries. The SIDCs act as catalyst for industrial development and provide impetus to investment in their respective states. The SIDCs provide financial assistance in the form of term loans underwriting / direct subsrciption to shares / debentures as also guarantees. They undertake a range of promotional activities such as preparation of feasibility reports, conduting industrial potential surveys and entrepreneurship development programmes and developing industrial areas and estates. Ths SIDCs are involved in setting up of medium and large industrial projects in the joint sector / assisted sector in collaboration with private entrepreneurs or as wholly-owned subsidiaries. The SIDCOs, also act as agents for providing tax benefits under the State Governments' package scheme of incentives. SIDCs also act as agents of IDBI/SIDBI for their seed capital scheme. Some SIDCs also offer a package of developmental services which include technical guidance, assistance in plant location and co-ordination with other agencies. In tune with the changing ecoomic scenario and financial sector environment, several SIDCs are making efforts to undertake the business of equipment leasing, merchant banking and mutual funds.

There are 28 SIDCs in the country. Eleven SIDCs also function as SFCs to provide assistance to small scale sector and to act as promotional agencies. Such twin-function SIDCs are in Andaman & Nicobar, Arunachal Pradesh, Damen & Diu and Dadra & Nagar Haveli, Manipur, Meghalaya, Mizoram, Nagaland, Tripura, Goa, Pondicherry and Sikkim, seven SIDCs are also involved in infrastructure and other.

The table 5.2 explains the details of financial assistance sanctioned and disbursed by SIDCO.

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Table 5.2
The Financial Assistance Sanctioned and Disbursed by SIDCO
(Rs. In crores)

S.No.	Year	Amount Sanctioned	Amount Disbursed
1	1980-81	-	-
2	1990-91	8.24	5.98
3	1991-92	10.09	6.79
4	1992-93	9.73	6.95
5	1993-94	9.18	7.01
6	1994-95	15.89	10.51
7	1995-96	19.51	11.89
8	1996-97	18.11	15.02
9	1997-98	23.13	14.22
10	1998-99	20.11	12.77

State Industries Promotion Corporation of Tamil Nadu (SIPCOT):

Established in 1971, the State Industries Promotion Corporation of Tamil Nadu Ltd. (SIPCOT) has been a catalyst in the development of medium and large scale industries in Tamil Nadu. Working in line with the State Government progressive industrial policies. SIPCOT has helped foster industrial development in backward and under developed areas. Totally commited to assisting the entrepreneurs. SIPCOT also provides institutional finance with refinance assistance from iIndustrial Development Bank of India and Small Industries Development Bank of India for meeting fixed capital Investment in industries.

SIPCOT mainly caters to the medium and major industries. Its activities comprise the following:

1. Provision of financial assistance to Medium and Major industries under IDBI/SIDBI refinance schemes.

2. Channelising incentives from the State Government to Industries

3. Construction of Industrial Complexes to act as growth centres.

Check Your Progress
6. The State Industries Promotion Corporation of Tamil Nadu Ltd. (SIPCOT) has been established in the year ______.

4. Monitoring of Letter of Intent and providing Escort Services to Medium and Major Industries.

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5.3.5 Lending Schemes :

SIPCOT's financial assistance to Medium and Major Industries is in the form of :

1. Term Loan under Normal Scheme..
2. Term Loan under Equipment Refinance Scheme.

a) Normal Term Loan Scheme :

SIPCOT extends term loan assistance to new units, expansion, diversification and modernisation schemes as well as for purchase of balancing equipment SIPCOT can extended long term loan upto Rs.300 lakhs for limited Companies and for Partnership Firms upto Rs.90 lakhs. The project cost can range from Rs.75 lakhs onwards and even beyond Rs.500 lakhs.

b) Equipment Refinance Scheme:

Assistance under this scheme for a maximum term loan of Rs.150 lakhs is available to the existing industrial concerns for purchase of identifiable equipment. The existing unit should have been in operation for atleast 14 years and should have made profit atleast during the preceding 2 financial years. The company sould have proven track record in fulfilling its obligation with financial institutions.

c) Term Loan / Project Cost Limits :

The limits on project cost and term loan have been enhanced with effect from 1.9.94. The details are given below:

i)	Project Cost Rs.500	*Category I & II	Term Loan from Rs.150 lakhs Lakhs to Rs.300 lakhs
		Category III	Rs.150 lakhs
ii)	Project Cost Exceeding Rs.500 lakhs	Category I & II Category III	Rs.300 lakhs Rs.150 lakhs

*Category I – Existing units with proven track record assisted by SIPCOT

Category II - Existing Units with proven track record assisted by AFIs/Banks.

Category III – New units promoted by First generation entrepreneurs.

In order to extend its record to the small scale as well, SIPCOT is new extending assistance to projects in the small scale sector with project cost exceeding Rs.75 lakhs.

A. State Capital Subsidy:

(Common for small, medium and large scale industries)

1. Subsidy for most Backward Areas:

A capital subsidy of 20% on fixed assets subject to a ceiling of Rs.15 lakhs is available to Industries set up in Most Backward Taluks (list annexed) and SIPCOT industrial Cmplexes at Tuticorin, Manamadurai and Pudukottai.

2. Subsidy for Backward Areas:

A capital Subsidy of 15% on fixed assets subject to a ceiling of Rs. 15 lakhs is available to industries set up in Backward Taluks (list annexed) and SIPCOT Industrial Complexes other then Tuticorin, Manamadurai and Pudukottai, Growth Centres and Industrial estates developed by Government Agencies, including SIDCO, Madras Export Processing Zone and Madras Metropolitan Development Authority.

3. Special subsidy for Electronic Industries:

Electornic units set up anywhere in Tamilnadu are eligible for a special subsidy of 20% on fixed assets subject to a ceiling of Rs.35 lakhs.

4. Special Subsidy for Leather Industries:

Leather units set up anywhere in Tamilnadu are eligible for a special subsidy of 20% on fixed assets subject to a ceiling of Rs.20 lakhs.

5. Special Subsidy for selected category of Industries:

A special subsidy of 10% on fixed assets subject to a ceiling of Rs.15 lakhs is available to medium and major industries for the following selected catagories set up anywhere in Tamilnadu.

i. Automobile Spare Parts.

ii. Drugs and Phamaceuticals.

iii. Solar Energy Equipment and other Non-conventional energy devices.

iv. Export oriented Gold Jewellery making and Diamond Processing Units.

v. Pollution Control Equipment.

vi. Jute Industry in 6 notified taluks.

vii. Food Processing Industry and

vii. Cost effective building materials like Aluminium or PVC Doors and Windows, of Special Recovery Tribunals to help banks financial institutions in the speedy recovery of their dues. Window Frames etc.

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In case of small scale industies in the above line of manufacture, thhe Subsidy will be at 20% onn fixed assets to a ceiling of Rs. 15 lakhs.

6. Special Subsidy for Pioneer Industries:

Any new unit with investment in fixed assets exceeding Rs.5 crores, being set up as the first unit in industrially backward or most backward taluks, where there is no such unit of that level of investment, is eligible for a capital Subsidy of Rs.25 lakhs.

New units with investment in fixed assets exceeding Rs.25 crores, being set up anywhere in Tamilnadu as also existing units, expanding or diversifying with additional fixed investment in excess of Rs.25 crores, are eligible for a capital subsidy of Rs.25 lakhs.

5. Special Subsidy for Mega Projects :

i) An industry set up anywhere in Tamilnadu having an investment of Rs.50 crores and above and below Rs. 100 crores is eligible for a capital subsidy of Rs.25 lakhs.

ii) An industry set up anywhere in Tamilnadu with an investment of Rs.100 crores and above and below Rs. 200 crores is eligible for a subsidy of Rs.40 lakhs.

iii) An industry set up anywhere in Tamilnadu having an investment of Rs.200 crores and above is eligible for a subsidy of Rs.100 lakhs.

6. Special Subsidy for efflent treatement plants :

A special subsidy of 10% of the value of assets created towards setting up of effluent treatment plant subject to a ceiling of Rs.2 lakhs is available for installation of effluent treatement plants by the existing tanneries.

7. Additional Subsidy for purchase of generators :

New generation purchased for captive use will be granted subsidy of 15% of the value of the Generators subject to a ceiling of Rs.5 lakhs. This subbsidy will be available to eligible industries, irrespective of their location in addition to backward areas subsidy/Special Subsidy.

8. Additional Subsidy for employing women workers :

New industrial units (Small, medium or major) where more than 30% of the total workers employed are women shall be eligible for an additional Capital Subsidy of 5% of investment in fixed assets to a ceiling of Rs.5 lakhs.

9. Special Subsidy for New Tourism Projects :

One star. Two star and Three star Hotels with investment less than Rs.100 lakhs, Amusement Parks, Approved Tour Operators (for A.C.Coachers). Golf Courses and Restaurants approved by Central/State Government, set up I Tamilnadu excluding the Corporation limits of Madras, Coimbatore and Madurai are eligible for Capital Subsidy of 10% on total investment excluding cost of land subject to a ceiling of Rs.10 lakhs.

Generator subsidy is also available to the above tourism projects.

B. Sales Tax Deferral / Waiver Scheme:

1. New Interest free sales tax deferral/waiver scheme for small, medium and major industries:

1.1 New units as well as existing units undertaking expansion/diversification are eligible for sales tax Deferral/Waiver Facility. This scheme is available to all areas of the state. Three different tracts in the State are covered with different quantum of assistance under this scheme.

1.2 Industrially Most Backward Taluks, SIPCOT Industrial Complexes at Tuticorin. Pudukottai. Manamadurai. Vikram Sarabai Instronics Esate. Electronic City at Sholinganallur in

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Chengalpattu M.G.R District and Industrial Estate at Perungudi, Madras.

1.3 Industrially Backward Taluks, SIPCOT Industrial Complexes other than those mentioned under 1.2 above, SIDCO Industrial Estates, all other Estates developed by Government Agencies including Madras Export, Processing Zone, Madras Metropolitan Development authority and Director of Industries and Commerce.

1.4 All other areas of the State not covered by theare as mentioned in 1.2 and 1.3 above.

2. New Units:

2.1 New small, medium and major industries set up in the areas as indicated under 1.2 above are eligible for full waiver of Sales Tax dues for a period of 5 years up to a ceiling of the total investment made in the fixed assets.

They can also have the option of availing 9 years deferral instead of 5 years waiver.

2.2. New industries set up in the areas as indicated less than 1.3 above are eligible for deferral of Sales Tax for 9 years to the full extent of total investments made in fixed assets.

2.3. The new units set up in other areas are eligible for deferral of sales tax for 5 years subject to a maximum of 60% of the total investment made in fixed assets.

2.4. The units which commenced commercial production on or after 18.4.1990 are eligible under this scheme.

3. Expansion / Diversification :

3.1 Existing industries undertaking expansion/diversification in the areas as indicated less than 1.2 above are eligible for full waiver of Sales Tax dues for a period of 5 years subject to a ceiling of additional investment made in fixed assets under expansion/diversification.

They can also have the option to avail deferral facility for 9 years instead of 5 years waiver.

3.2 Existing industries undertaking expansion/diversification in the areas as indicated less than 1.3 above are eligible for deferral of Sales Tax for a period of 9 years subject to a ceiling of 80% of additional investment made in Fixed assets under expansion/diversification.

3.3 The existing units in other areas are eligible for deferral Sales Tax for 5 years upto 50% of additional investment in fixed assets.

4. Sales Tax deferral facility for Hotels :

Sales Tax deferral for a period of five years is allowed to One Star. Two Star and Three Star Hotels set up in Tamilnadu or after 20.1.1992, excluding the corporation limits of Madras, Coimbetore and Madurai, with investment of less than Rs.100.00 lakhs, as applicable to other new industries in fixed assets.

5. Sales Tax deferral / waiver facility for Mege Projects :

5.1 An industry set up anywhere in Tamilnadu having an investment of Rs.50 crores and above and below Rs. 100 crores is eligible for Sales Tax waiver facility for 5 years or deferral facility for 10 years subject to a ceiling of 100% of the value of fixed assets.

5.2 An industry set up anywhere in Tamilnadu having an investment of Rs.100 crores and above and below Rs. 300 crores is eligible for Sales Tax waiver facility for 6 years or deferral facility for 12 years subject to a ceiling of 100% of the value of fixed assets.

5.3 An industry set up anywhere in Tamilnadu having an investment of Rs.300 crores eligible for Sales Tax waiver facility for 6 years or deferral facility for 12 years subject to a ceiling of 100% of the value of fixed assets.

5.4 An industry set up anywhere in Tamilnadu having an investment of Rs.300 crores eligible for Sales Tax waiver facility for 7 years or deferral facility for 14 years subject to a ceiling of 100% of investment in fixed assets.

Sales Tax (TNGST) Reimbursement Scheme:

A. Mepz Units :

Industries located in the Madras Export Processing Zone (MEPZ) are eligible for the reimbursement of Tamil Nadu General Sakes Tax (TNGST) paid on purchase of raw materials and capital goods from the domestic tariff area for three years for 1.4.1993.

Check Your Progress
7. MEPZ stands for ________.

B. 100% Export Oriented Units:

100% Export Oriented Units Located anywhere in Tamil Nadu are eligible for reimburesment of Tamilnadu General Sales Tax (TNGST) paiid on purchase of raw materials and capital goods from the domestic tariff area area for two years from 1.4.1994.

General Points on Incentives:

1. Second hand assets are not eligible under incentive scheme. However imported second hand machineries are eligible under State Capital Scheme.

2. Normal (Backward Area) subsidy is not available for medium/large industries existing/ being set up expanded/diversified within 50 km radius of Madras City limits or within the municipal limits of other municipalities and municipal township.

However industries in Madras Export Processing Zone, SIPCOT Complexes and other Industrial estates Development by the State Government agencies including SIDCO and Madras Metropolitan Development Authority, even failing within 50 km Zone of Madras and 15 km zone of Madurai and Ciiombatore and in other Municiple areas, are eligible for subsidy. Locational policy restriction will not be applicable to special subsidy for selected category of industries and Mega Projects.

3. The existing industries undertaking expansion/diversification are eligible for incenitves without any limit to the number of expansion/diversification. The project for expansion should envisage a minimum of 15% increase in the value of production of the unit undertaking expansion irrespective of whether it is undertaken by an individual industry, an industrial group or any other legal entity. That is the increase in turn over should be atleast 15% of the existing turnover. In the case of diversification, the envisaged additional turnover oa account of diversification should be atleast 15% of the existing turnover of the company/firm, undertaking diversification

4. Sales Tax Deferral/Waiver Facility includes TNGST, CST, Surcharge, additional Surcharges and additional Sales Tax (Turnover Tax)

Escort Services:

SIPCOT offers guidance to medium scale entrepreneurs for selecting a suitable venture. Further it also offers escort services to enable the entrepreneurs to obtain required consents and clearances for the project. It also monitors letters of intent issued to medium and large scale industries in Tamil Nadu.

SIPCOT has presently 7 project offices at Hosur, Ranipet, Gummidipoondi, Tuticorin besides 2 regional offices at Madras and Tuticorin.

5.3.5 Industrial and Technical Consultancy Organisation of Tamilnadu Ltd (ITCOT)

ITCOT was established in 1979 as a public limited company to provide a wide range of consultancy services. Project feasibilities studies, technical and administrative assistance, managerial consultancy, market surveys and several other vital services provided bby ITCOT, help industries and entrepreneurs to stare off in the right direction.

ITCOT's range of services :

- For a new enterprise/diversification.
- Identification of projects to suit their requirements.
- Project appraisals for companies going for public issue.
- Feasibility studies.
- Detailed project reports
- Technology sourcing and choices
- Evaluation of take over opportunities.
- Assistance in obtaining loans and government approvals.
- Project management assistance.
- Market surveys.
- Project monitoring.
- Appraisals for new or right issues.
- Management consultancy.

Check Your Progress

8. ITCOT was established in 1979 as a public limited company to provide a _____.

For Ongoing Enterprises:

- Modernisation reports and assistance.
- Productivity improvements.

- Energy saving studies
- Financial consultancy
- Marketing consultancy
- Ancillary Development training.
- Management development training.
- Sick unit rehabilitation assistance
- Advisory and information reserves to corporate planning departments
- Management development training programmes
- Total Quality Management (TQM)
- Management Information System (MIS).

Performance of ITCOT for the year 1994-95

The table 5.3 explian the details of studies conducted by the ITCOT.

Table 5.3
The Detail of studies.

	During 1993-94	During 1994-95
Project Reports and Pre-Investment Studies	189	69
Market Survey Reports	6	7
Diagnostic Studies and Plant Visit Reports	7	4
Project Appraisals and Special Studies	13	40
Energy Conservation Studies and Wind Farm Studies.	5	13

The table 5.4 explains the Working Results of the Company.

Working Results

Table 5.4

	1993-94 (Rs. In lakhs)	1994-95
I Income :		
A. Operating Income	71.58	93.09
B. Interest Income	5.00	4.74
C.Other Income	0.62	0.47
Total	77.20	98.30
II. Expenditure	72.85	93.23
Profit	72.85	93.23
III Provision For Taxation	2.24	2.85
Profit Retained	2.11	2.22

Assignments handled during 1994-95:

ITCOT contiued with its regular work of supporting the efforts of new entrepreneurss to enter industry and business, existing entrepreneurs to expand / diversify or restructure their business and carried out a number of appraisal studies for medium and large industries which seek to raise resources in the capital market.

There was conspicuous shift in the nature of assignments handled by your company this year Larger projects came up for appraisals land consequent to an understanding signed between Indian Renewable Energy Development Agency and your company a number of assignments were undertaken in the realm of Renewable Sources of Energy, chiefly the wind farm projects steps have also been initiated during the year to enter into MOU's with Foreign Consultancy Organisation for Exchange of resource potential.

The varied assignments include studies entrusted by TIDCO. DST. SIDBI. TACID and Indian Bank.

Apart from these, private organisations and voluntary organisations, entrusted consultancy assignments for preparing feasibility report for starting an insurance company. Accredition of Consultants in Tamil Nadu, preparing a feasibility report and appraisal report on Housing Finance Company which are newer type of assignments considering the routine assignments so far handled by your company. Further more the project work of Department of Electronics (DoE) on Rural needs for Electronics of Future was handled thruoghout the year, the project being a large volume project.

Training Programmes Conducted:

The company continued with its entrepreneurship Development Programmes and carried out twelve Entrepreneurship Development Programms during the year two of them exclusively for women, two of them for science & technology personnel and eight for general canditates withh financial support from various agencies. A total number of 304 persons were trained.

The company also conducted an innovative programme to train barefoot managers for small industry- Small Industries Management Assistance Programme (SIMAP) at Tiruppur, sponsored by the small Industries Development Bank of India.

ITCOT conducted several other programmes as well, important among them being a Business Meet on equipment finance for setting up of Wind Farms sponsored by Indian Renewable Energy Development Agency, a National Colloquium on Technology Assessment jointly with Asia and Pacific Cente for Transfer of Technology (APCTT), CSIR and Anna University, a management Advancement Programme for thhe TIIC assisted enterprises.

Apart from this, skill upgradation programms were also conducted for the small scale Leather and Textile industries. Specialised programmes on energy conservation were held for the technical personnel of Cement, sugar and Steel industries at Madras under the Energy Management Consultation and Training (EMCAT) programme, funded by United Sates Agency for International Development through the industrial development benk of India.

5.3.6 Small Industries Development Corporation Limited (SIDCO) :

Small Industries Development Corporation Limited (SIDCO) was set up by the Govt. of Tamilnadu. With the specific objective of playing a catalyst role in the promotion and development of Small Scale Industries and to has then the Industries dispersal in backward and under developed areas of the State. It commercial our activities in 1971 with comprehhensive promotional programme designed to stimulate entrepreneurship.

SIDCO has implemented a number of fiscal and other incentives on Government's behalf to the Small Scale Industries, particularly to stimulate self-employment among Technocrats. It is one geared up for a more effective and comprehensive promotional role to catalyse a more rapid growth with a new outlook, viz., Marketing approach to industrial promotion.

SIDCO's role:

SIDCO function is to plan and catalyse the development of Small Scale Industries in Tamilnadu and our promotional activities comprise of the following:

1. Develoment of potential growth centres and provision of factory sheds of various dimensions and developed plots with all infrastructural facilities, to make it easier for the entrepreneur to invest in small scale industries. Tiny Sector Sheeds for Artisans, Craftsman and those willing to be self-employed are also part of our programme.

2. Providing Package of incentives, such as central investment subsidy (CIS), state Capital Subsidy (SCS), Special Subsidy for selected category of industries. Margin Money Assistance (MMA) for rehabilitation of sick units and power tariff subsidy.

3. Supply of scarce raw materials such as Iron & Steel, Copper, Fatty Acid, Zinc, Lead, Potassium Chlorate, HDPE etc., through our wide distribution network.

4. Rendering Marketing Assistance with incentives like Price Preference, Priority in Govt., purchases and advence payment with placement of orders.

5. If you produce goods of export quality, SIDCO's Export Division will help you to market your products, overseas.

6. Entrepreneurs Guidance Cell (EGC) and Escort services to help your needs.

Single Window Approach:

To encourage the first generation entrepreneurs among certain selected catagories to set up industries, without much botheration of approaching various agencies for assistance. SIDCO extend all facilities and provide escort services under one roof.

Check Your Progress

9. Small Industries Development Corporation Limited (SIDCO) was set up by

NOTES

SIDCO has formulated a special package of assistancc for the priority categories of first generationn entrepreneurs, ·wherby ready built sheds of various sizes with all infrastructural facilities and supply of machinery will be offered on easy hire purchase terms. In deserving cases, seed capital assistance will be extended to supplement promoter's contribution. Besides these SIDCO will tie up with Nationalised Banks for working capital requirements.

A) **Provision of Worksheds:**

SIDCO identifies and develop growth centres at various locations and provide factory sheds of various sizes and developed plots with all basic infrastructural facilities. It allot them to entrepreneurs who are ready to start Small Scale Industries with concrete proposals.

SIDCO has so far developed 49 industrial estates (please see the list of SIDCO's Growth Centres in Annexure I) including Functional Estates. The latest to be commissioned is the Functional Estate for Drugs and Pharmaceuticals at Alathur in Chengalpattu Dt., (40 kms from Madras near Mahabalipuram). There are a number of growth centres in the various stages of development like, Gummidipoondi, Maraimalainagar, Tuticorin, Hosur (Pahse V) Cuddalore etc.

B) Fiscal Incentives:

a) Central Invetsment Subsidy Scheme:

Govt. of India have liberalised the Central Investment Subsidy Scheme from 1.4.1983 and divided the areas eligible under the Scheme. in to the following categorie as under –

CATEGORY 'B' - Rs.15% of the Fixed Capital Investment subject to a Maximum of Rs.15.00 lakhs.

CATEGORY 'C' - Rs.10% of the Fixed Capital Investment subject to a Maximum of Rs.10.00 lakhs.

A list of taluks in Tamilnadu eligible for 15% / 10% CIS Scheme under categories 'B' & 'C'. New Small scale industries as well as the expansion units of the existing units in the selected taluks will be given on outright grant of subsidy equivalent of 15% / 10% of the Fixed Capital Investment. We are the Agency for implementation of the scheme for Small Scale Industries in Tamil Nadu.

For availing this assistance one has to get registered with us before taking effective steps. Sanction will be accorded by the State Level Committee as soon as you tie up the project and you may avail upto 85% of the sanctioned amount before you go into commercial production. Balance 15% can be availed by you after commencing commercial production.

b) **State Capital Subsidy:**

The Govt. of Tamilnadu have selected 33 backward taluks in addition to the taluks mentioned in a and certain growth centres like Tuticorin and Cuddalore for grant of Capital subsidy of 15% of the assets created. The terms and conditions are similar to the Central Investment Subsidy.

The same procedure as applicable to Central Investment Subsidy Scheme will be followed for this scheme.

c) **Subsidy for Selected Categor. of Industries:**

In order to encourage non-traditional industries which have scope in Tamilnadu, the Govt. of Tamilnadu offers a special Subsidy equivalent to 10% of the Fixed Assets created or at the rate of Rs.20000/- per every regularly employed worker with an overall monetary ceiling of Rs.10.00 lakhs. The following type of Industries set up anywhere in Tamilnadu not covered by the State or Central Subsidy scheme sre eligilble to be benefitted under the scheme.

a) Electronics

b) Drugs and Formulation of Scheduled drugs

c) A selected list of equipment, machinery etc.. to tap solar energy for domestic and other industrial uses.

d) Effluent Treatment Plants established by Tanners for Pollution control (Subsidy restricted to a monetary ceiling of Rs.5.00 lakhs)

The same procedures and conditions as applicable to the state Capital Subsidy Scheme will apply for this scheme.

d) **Power Tariff Subsidy:**

Power Tariff Subsidy will be available to all registered SSI units. L.T.Power Consumption by Small Scale Industries started after 1980 are subscribed in the first 3 years. The power tariff subsidy ranges from 30% of the energy charges in the first year to 10% of the energy charges paid up in the 3rd year.

The Scheme is in operation though out the state excluding the areas coming under MMDA Urban land tax jurisdiction (namely; Madras and its environs and towns of Coimbatore, Madurai, Trichy and Salem)

e) Interest Free Sales Tax Loan:

As a further concession to smal scale industries the Govt. of Tamilnadu gives interest Free Sales Tax Loan over a period of 6 years, equivalent to the Sales Tax paid by them in each year, subject to a maximum of 20% fixed assets created or Rs.4.00 lakhs per annum whichever is higher (this scheme is now implemented by Director of Industries & Commerce). For small scale industries coming up in our growth centres under our auspices, this scheme will be implemented by us.

f) Margin Money Assistance for Rehabilitation of Sick Units:

The Govt. of Tamilnadu has evolved a Scheme for the revival and rehabilitation as sick units in the SSI sector. This scheme is implemented by SIDCO.

Under the scheme, interest free margin money loan (MML) is extended to sick units to enable them to meet a portion of promoter's contribution, required for availing fresh additional facilities/assistance from financial institutions/commercial banks, under the Revival Programme.

The quantum of assistance will range between 50% to 75% of the cost of the project and additional contribution required to be put in by the entrepreneurs as Margin Money.

The Margin Money will be required to be repaid within 5 years after a moratorium period of 4 years.

Small Scale Industries Units who reauire this assistance have to apply to us in the prescribed from with a copy to the Director. Small Industries Service Institute, G.S.T.Road, Guindy. Madras-32 and the rehabilitation proposal prepared for the sick SSI units will be considered speedly by a Sub-committee.

C) Raw-Material support:

ISCO help small scale sector industries with scace raw-materials like Iron & Steel, Coke, Potassium Chlorate, Lead, Zinc and Fatty Acid. These are procured in bulk quantities by us and distributed to the SSI units' thrugh our distribution network spread all over the state.

Check Your Progress

10. ________ provided by the Govt. of Tamilnadu for the revival and rehabilitation as sick units in the SSI sector.

SIDCO plans to enlarge our activities in this regard by procuring more various of Raw-materials and supply them, by opening additional Depots and Sub-Depots, wherever there is a justification.

D) Marketing Assistanc:

Govt. of Tamilnadu in order to encourage Small Scale industries, gives price preference and priority in purchase to the products of small scale industries in Tamilnadu. This scheme is implemented by us. We also participate in Tenders, floated by the Director General of Supplies and Disposals (DGS&D) and distribute the orders to the small scale industries, which are in that particular line of manufacture.

In accordance with the Govt. Policy, SIDCO gives preference to those SSI Products with ISI markings in implementing our marketing support.

SIDCO arranges buyer's and sellers meets which provides sample opportunity for you to tap markets locally and abroad. To reap the benefit of the Scheme first of all you must be a registered SSI unit and you have to apply to us in the prescribed from with a normal fee of Rs.100/- towards marketing support registration.

E) Rehabilitation of Sick Units:

SIDCO has set up a separate cell to identify sick units and to formulate revival programmes through ITCOT/SISI. It brings in all organisations involved in the nursing programme under one roof to extend necessary support for revival. If the proposals are viable sick units can avail margin money assistance through us.

F) Thrust on Exports:

To make our contribution to the national economic development we have recently set up a separate Export Division poised to market export quality goods in foreign markets through Govt. agencies concerned/recognised export houses in foreign countries.

II Package of assistance for the first genertaion entrepreneurs through a single window:

SIDCO has evolved a Special Package of Assistance to make it easier for the first generation entrepreneurs among certain selected categories to start a Small Scale Industry and run it successfully SIDCO will function as the single-window for implementing this scheme in the selected centres.

SIDCO has presently 17 Branch Offices spread all over Tamilnadu.

5.4 Summary:

The State financial institution plays a vital role in promotion and development of an industry in all states by providing financial assistance in various forms.

5.5 Keywords used in the lesson

- ✓ State Financial Corporations
- ✓ Forms of assistance

5.6 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e.
Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets, Institutions and Services, 3/e,
by
Bharati V. Pathak

5.7 Answer to check your progress question

1. 1949
2. 250 lakhs
3. Power Intensive Industries
4. Generator Subsidy
5. Tamilnadu Indstrial Development Corporation Ltd
6. 1971
7. Madras Export Processing Zone
8. Consultancy services
9. Entrepreneurship
10. Margin Money Assistance

5.8 Model Questions

1. State the circumstances leading to the establishment of SFCs in India and briefly relate their functions.

2. What are the major schemes operated by TIIC?

3. Enumerate the various steps involved in setting up an industry.

4. What are the reasons for establishing TCOs in the country? In your opinion are they accomplishing their goals of establishment?

5. Enumerate the Functions of ITCOT in Tamilnadu and its operations during 2000-2001.

6. What is the role being played by TIDCO in the promotion of industries in Tamilnadu?

UNIT – 6

LEASING

6.1 Introduction
6.2 Unit Objective
6.3 Unit structure
6.3.1 Meaning and Definition of Leasing;
6.3.2 Type of Leases;
6.3.3 Merits of Leasing:
6.3.4 Demerits of Leasing
6.3.5 Leasing around the world
6.3.6 Leasing in India
6.4 Summary
6.5 Keywords used in the lesson
6.6 Further reading
6.7 Answer to check your progress question
6.8 Model Questions

6.1 Introduction

Economics is concerned with five factors namely, men, machine, money, material and market. Of these money is the most critical factor all around the world. Money comes in three forms, own finance, debt finance and lease finance. While own finance is in practice from day one of economic activity, debt finance entered a liitle later. Lease finance which acts as a major route to industrial finance, took shape only during the second half of this century.

6.2 Unit Objectives

- To understand the different types and features of lease
- To find the leasing practices in India and world

6.3.1 Meaning and Definition of Leasing:

The International Accounting Standard – 17 (IAS – 17) defines a lease as, "an agreement whereby the lessor conveys to the lessee, in return for rent the right to use an asset for an agreed period of time".

Equipment leasing Association defines a lease as "a contract between a lessor and a lessee for the hire of a specific asset selected from a manufacturer or vendor of such assets bby thhe lessee. The lessor retains the ownership of the asset. The lessee has possession and use of the asset on payment of specified rentals over a period of time.

James C. Van Horne defines, "Lease is a contract whereby the owner of an asset (lessor) grants to another party (lessee) the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent".

History of Leasing:

The concept of leasing can be traced back; to the years before the birth of Christ. One the Western Coast off the Mediterranean Sea, about 1400 B.C., the phoenician civilization, which developed alphabets and which wathe immediate fore runner of the Greek civilization, leased charter ships to merchants who were more interested in conducting their business than in the ownering of vessels.

In the mesapotamian Valley, land leasing was in practice around 550 B.C., the object being to develop the unused land and to keep the house in good repaid.

Land-leasing was in use throughout the dark ages and the early periods of colonization. As an example Maryland was a totally leased colony of land Baltimore, who owned the land and all the inhabitants became hhis tenants.

Coming to recent times, the practice of leasing to finance the acquisition of capital assets has its immediate origins in the Nineteenth century. T.M.Clark has started that the growth of the raiway system and mortage of finance to require railway wagons during the mild nineteenth centuru had led to the formation of leasing companies in the United Kingdom. Interestingly one such companies the North Central Wagon Company, which in 1971 merged with Lombard Banking to form Lombard North Central, has survived to the present day. Even though leasing was replaced by Hire Purchase in the later part of thh nineteenth century. Leasing of railway wagon was in important influence on the future patterns of business finance in the U.K.

To start it simply leasing is an agreement between the lessor (the owner of the asset) and the lessee (the user of the asset) to make use of the asset for a particular period of time and for a specified rent.

Thus the lessor will provide the required asset to the lessee, on the request of the lessee and lessee will use this asset for his business ans / or industrial activity till the end of the contract period and pay, a defined consideration, known as the lease rent, to the lessor periodically. Once the contract period is over the lessee will cease to be the user of asset and he has to return the possession of the asset to the lessor. Hence the lessee will never be owner but only the user and the lessor will be the holder of title of the asset.

6.3.2 Type of Leases;

There are several types of lease in practice. The Chart 6.1 gives details about the type of lease.

A. Financial Lease:

International Accounting Standard 17 defines financial lease as "a lease that trnsfers substantially all the risks and rewards indent to ownership of an asset. Title may not eventually be transferred".

It is also known as capital lease, long term lease, net lease and close lease.

Rule 13 of Financial Accounting Standard Board (FASB) of the USA describes four conditions to consider a lease as a financial lease.

1. The lease transfers ownership of the properly to the lessee by the end of the lease term. The term is defined as the fixed non-cancelable term of the lease plus any options specified in the contract.

2. The lease contains a bargain option or a provision that allows the lessee at his option to purchase the leased property for a price lower than the expected fair market value of the property.

3. The lease term is equal to 75 percent or more of the estimated economic life of the leased property. If however the beginning of the lease falls within the last 25 percent of the total economic useful life of the leased property, including earlier years of use, this criterion is not used for classifying the lease.

4. The present value of the lease at the beginning of the lease term of the minimum lease payments, excluding executory costs such as insurance, maintenance and taxes to be paid by the lessor, including any profit thereon equals or exceeds 90 percent of the excess fair market value of leased property to the lessor at the inception of lease over any related investment ax created retained by the lessor and expected to be realised by him. This Criterion is not used if the lease term falls within the last 25 percent of the total estimated economic life of the leased property. The lessor computes the present value using the implicit interest rate and lessee uses his incremental borrowing rate unless he can use the lessor's implicit interest rate. The lessor's implicit interest rate must be used if this rate is less than the incremental borrowing rate.

Check Your Progress

1. A lease that transfers substantially all the risks and rewards indent to ownership of an asset, which is called as _______.

2. In general, the lease term is equal to more than _______ % of the estimated economic life of the leased property.

CHART 6.1

TYPE OF LEASE

Financial lease — operating lease

Operating lease: Dry lease, wet lease

Direct Lease | Sales and Lease back | Leveraged lease | International Lease | Big Tciket Lease

Bipartite Lease | Tripartite Lease | Import Lease | Cross Border Lease

No clear out, legal definition regarding Financial Lease is available in India. However, the first two conditions can not be applied in India, because inclusion of any such conditions in the agreement will result in the agreement being treated as hire-purchase agreement not a lease agreement.

Financial lease may be described. under Indian companies as a long term non-cancelable lease and during the major part of the life of the asset. it is used maintained and card for by the lessee with the title being held by the lessor which will never be transferred to the lessee under lease agreement. Financial lease may be classified as follows:

1. Direct Lease
   - a) Bipartite Lease
   - b) Tripartite Lease
2. Sale and lease back
3. Levraged lease
4. International Lease
   - a) Import Lease and
   - b) Cross Border Lease
5. Big ticket lease

1) **Direct Lease:**

The FASB defines direct lease as follows:

A direct lease is one the does not include provision in the lease payment for lessor profit, meets one or more of the criteria used to define financial lease or capital lease and has a reasonably hhigh predictability of collection of lease payments.

Wajnert' characterises direct lease by the following attributes:

i) Duration of three to seven years

ii) The lessor holds the title

iii) The lessee may review or purchase at the expiration of the lease term.

iv) May have mid-stream trade in position.

v) Usually full pay out.

In other words direct lease is a simple lease where the lessee directly acquires the equipment from the manufacturer or the lessor. The direct lease is of two types.

a) Bipartite Lease and

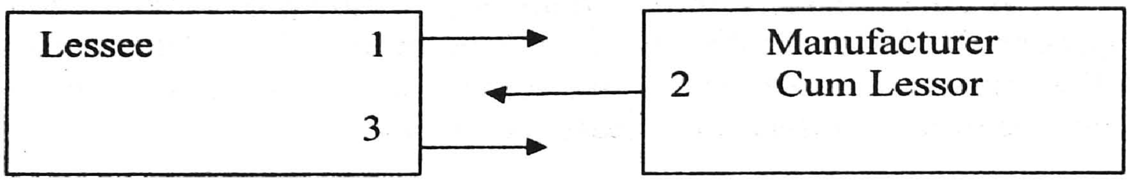
b) Tripartite Lease

a) Bipartite Lease:

Two parties are involved in this type of lease first the manufacturer as the lessor and second, the lessee. The lessee will approach the manufacturer directly and get the required equipment and in turn, will pay the lease rent directly to the manufacturer who plays a dual role. This agreement may have facilities like upgradation of the equipment or additions to the original equipment configuration. The following chart6.2 explains the process of direct lease.

CHART 6.2

Process of Bipartite Lease



1. Lessee will approach the manufacturer-cum-lessor with the proposal

2. Manufacturer-cum-lessor will supply the equipment.

3. Lessee will pay the rent periodicall.

In Bipartite lease if the lessor, i.e. the manufacturer agrees to maintain the equipment and even replaces the equipment that is in need of major repair with similar equipments in working condition, it is called swap lease.

b) Tripartite Lease:

In this type of lease three parties are involved

i) Lessor, who will finance and owner of the equipment.

ii) Lesssee, the user of the equipment and

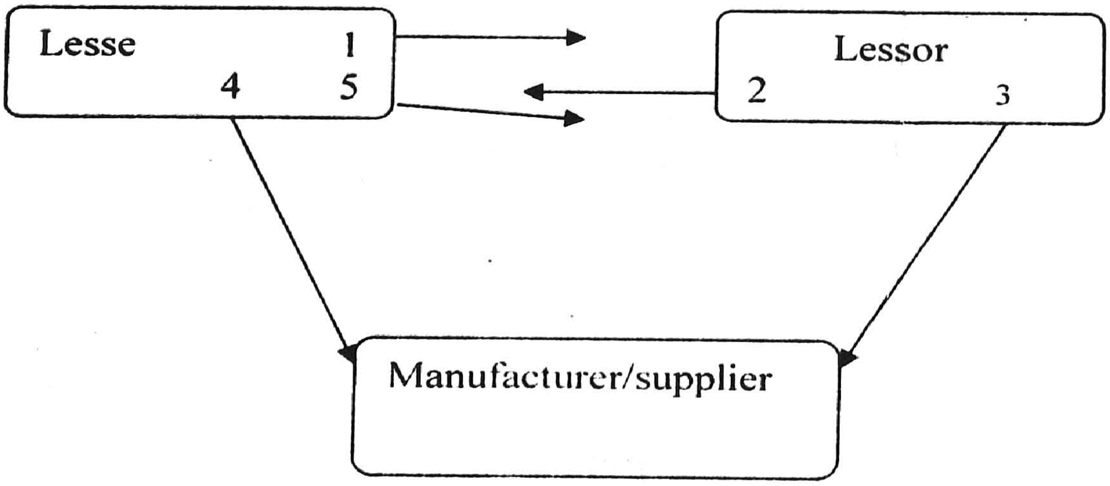
iii) The Manufatcurer

Unlike the prevous case, here the manufacturer and the lessor are two different parties.

The process can be explained through the following chart 6.3

Chart 6.3

Process of Tripartite Lease



1. Lease approaches the lessor with all details about equipment, equipment manufacturer/supplier.

2. Lessor approves of the proposal and enters into contract with lease.

3. Lessor approaches the manufaturer or supplier and place the order makes all the necessary payments and gives him instructions regarding place, date and the time of delivery of the equipment.

4. Manufacturer / supplier supply the equipment to the lessee.

5. Lessee pays lease rent periodically to the lessor.

2. Sale and Lease Back:

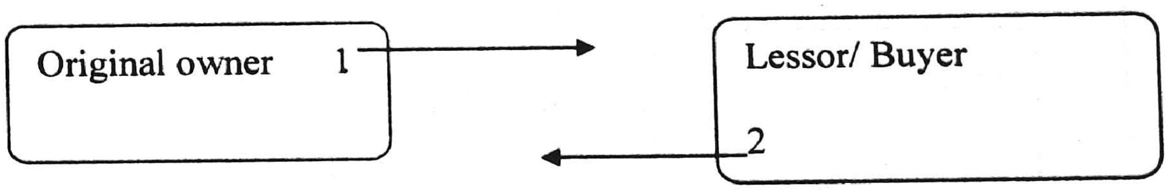
This is another type of leasing, popular in the U.S.A and becoming popular in India. Here the firm sells its equipment to the lessors and hires it back from the lessor. Hence the firm, which first owns, becomes the lessee later.

They can be explained is two stages.

Stage A: Original owner of equipment sells the asset to the lessor and gets the consideration of sale as per the agreement.

Chart 6.4

Process of sale



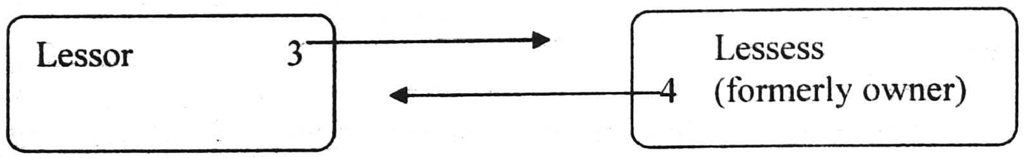
1. The Original owner sells asset to the lessor.

2. The lessor gives the sale amount to the owner.

Stage B : In the second stage the original owner hires the asset from the lessor and plays lease rent periodically..

Chart 6.5

Process of Lease Back



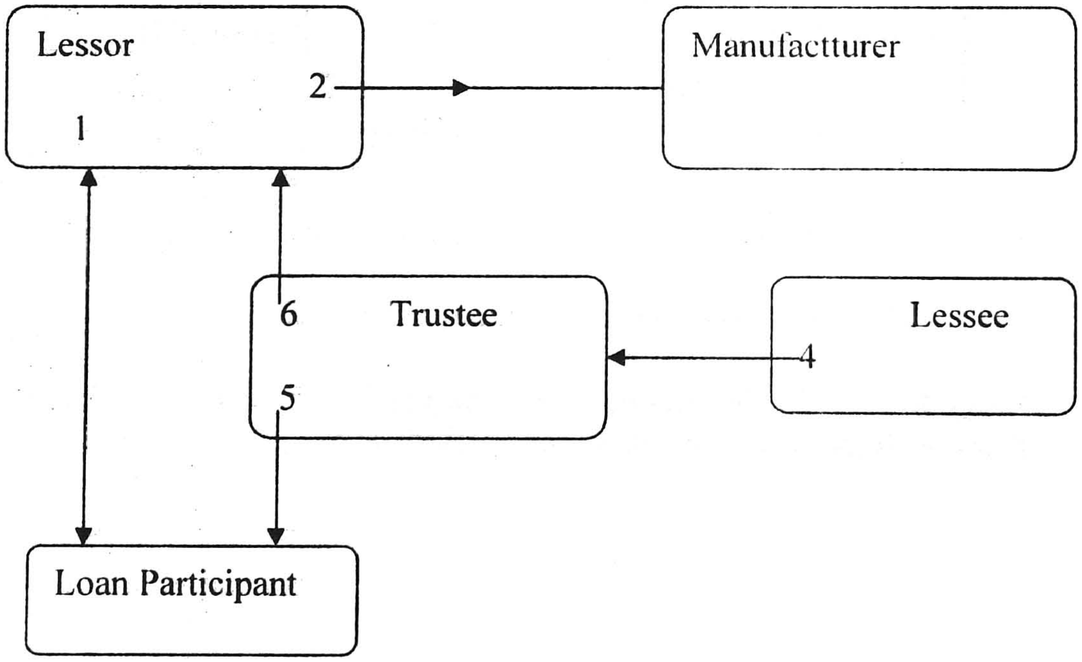
3. Lessor gives the possession of the equipment to the lessee, formerly the owner of the asset.

4. Lessee pays lease rent to the lessor.

3) Leveraged Lease:

In leveraged lease there are five parties involved against two or three in the direct lease. The new parties are lenders or loan participants and trustees. The difference in the number of parties involved results from the fact that in leveraged lease the owner or lessor puts up only a fraction of the investment cost and borrows the rest from other sources. The loan is usually secured by a mortgage on the equipment as well as by the assignment of the lease and lease payments. The process is done through trustee. The trustees collect the rent from lessee and settle the portion of claim of lender or loan participant first, which is interest and capital and gives back the balance to the lessor.

Chart 6.6
Process of Leveraged Lease



Check Your Progress
3. In ______, there are five parties involved against two or three in the direct lease.

1. The lessor and lender, the loan participant, come to an agreement and the lender pays his contribution.

2. Lessor place the order with manufacturer and fulfills all formalities.

3. Manufacturer supplies the machinery to the lessee.

4. Lessee pays the lease rent to trustee.

5. Trustee pays the interest and principal portion from lease rent collected.

6. Trustee pays the balance to the lessor.

4. International Lease:

If the leasing process goes beyond frontiers of one nation, it is called international lease. International lease can be classified into two

a) Import Lease and
b) Cross Border Lease.

a) Import Lease:

Here lessor and lessee are located in one country and the manufacturer is located in another country. In this process the lessee approaches the lessor who is located in the same country with all the details about the equipment and manuafacturer. Once an agreement is made, the lessor will place the order with the manufacturer who is located outside the country. The manufacturer supplies the required asset, i.e the equipment is imported into the lease's country. This is called import lease. This lease is essential when the required equipment is not available locally at the required price.

b) Cross Border Lease (CBL):

In this type of leasing unlike import lease, the lessor and lessee are located in different countrie. The location of manufacurer is immaterial. In practice Cross Border Lease is more difficult and risky due to fluctuation in exchange rate, political relationship between the countries. complexity of legal procedure of countries etc. however, CBL is gaining more importance due to the following reason:

a) The lease can be arranged to have maximum tax benefits by taking the advantage of tax concession and incentives offered in two different countries.

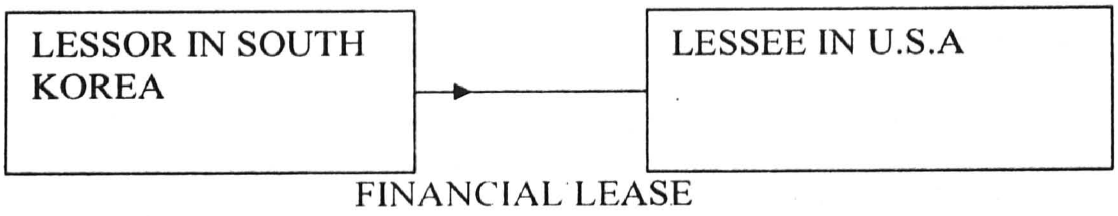
b) This offers requuired volume of fund at a reduced interest rate.

Check Your Progress
4. The leasing process goes beyond frontiers of one nation, which is called as _______.

c) Lessor's market is widened over the territory of other country.

Since leasing is very much depending on tax benefits and other allowances, the first reason play a major role in the popularity of CBL. Every country has their own rules and definition with regard to benefits and beneficiary of investment allowance and leasing. This helps the lessor and lessee enjoy more benefits in their own country and they are able to quote a lesser price. For example, in South Korea the investment allowance otherwise known as capital allowance is given to the owner of the asset or lessor. But in U.S.A the same benefit is given to lessee since the lessee will be the owner or he has the option to purchase the asset at the end of lease them,as per the law in U.S.A. now let us assume that lessor is located in South Korea and the lessee is located in U.S.A. The lessor will enjoy inestment allowance in South Korea and the lessee is located in U.S.A. the lessor will enjoy enjoy investment allowance in South Korea and the lessee will enjoy the same in U.S.A. the following chart will explain this process.

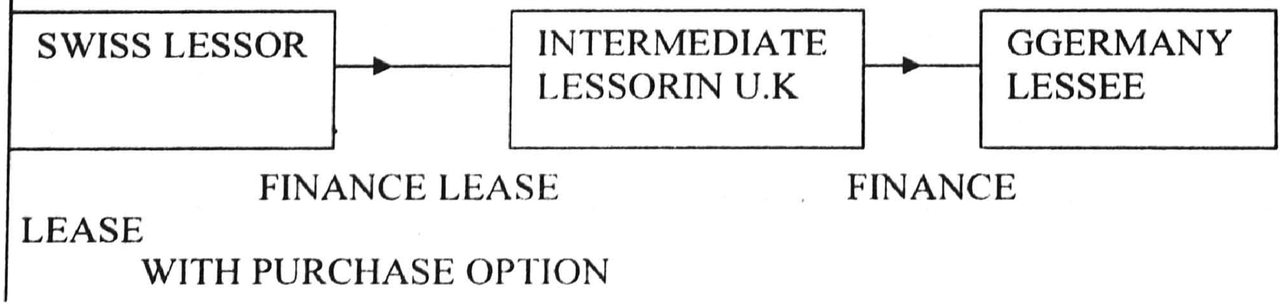
Chart 6.7
Cross Border Leasing – Double Dip Transaction



In south korea this lease is treted as " True Lease " and lessor in south korea is eligible for capital allowance. But in U.S.A it is treated as sale and capital allowance is claimed by the lessee in U.S.A. this dual tax benefit is called 'Double dip" advantage. Similarly,"Multiple dip" advantage also is possible, if more than two countries are involved. For example consider a Switzerland based lessor is writing a lease with a purchase option with an U.K. based intermediate lessor and this lessor writing a lease that resembles an installment sale with a lessee in germany. The multiple tax benefits associated with this transaction is schematically presented in Chart 5.9

Chart 5.9

Strcuture of Multiple –Dip Transaction



NOTES

(Source: Hand Book of Leasing, Hire Purchase and Factoring by k.sriram and published by ICFAI, Hyderabad)

In Switzerland, this is treated as true lease and the Swiss lessor claims capital allowance. Any agreement with purchase option is treated as Hire-purchase in U.K. so U.K. intermediate lessor will get capital allowance there. At the same time capital allowance, in Germany this is treated as installment putrchase and German lessee claims capital allowance. This is called multiple –dip.

B. Operating Lease:

The term operating lease or service or maintenance lease is used by FASB, the IRS and the leasing community, but not always in the same context. FASB 13 defines an operating lease in terms of both the lessee and lessor as follows:

For the lessee it includes all leases that are not Finance or Capital lease.

For the lessor, it includes all other leases that is, those which are not financial, leveraged and the like.

An operating lease is an agreement by which the lessee acquires the use of an asset on a period-to-period basis. That is, instead of taking an asset on a long term basis at one point of time lessee prefers the system of hiring an asset for each period with the option of renewing the same after its expiration date. In otherwords such lease contracts are for periods shorter than the useful life of the asset and are cancelable at the option of the lessee.

The Institute of Chartered Accountants of India defines operating lease as follows;

"A lease is classisfied as an operation lease, if it does not secure for the lessor the recovery of his capital outlay plus a return on the funds invested during the lease term"

The leasing community views an operating lease as one having the following characteristics:

a) The lease does not involve an extension of credit or longterm fixed commitments.

b) The lessor may provide special services, such as maitenance.

c) The lease is of short duration compared to the economic life of the asset and

Check Your Progress
5. The operating lease is otherwise called as ______.

d) The lease is cancelable within reasonable restrictions.

The operating lease can be derived as a short term, cancelable lease where the operating expenditure is taken care of by the lessor himself. When the operating expenditure, insurance and maitenance are taken care by the lessor, it is called wet lease and if it is not so, it is called, dry lease. It is also known as service lease, short term lease or true lease.

6.3.3 Merits of Leasing:

Leasing offers lot of advantages to the lessor and lessee. They are:

To Lessee:

a. Flexibility:

Lease rent can be fixed according to the conveinence of the lessee. It may be, for example, equal/uniform rent throughout fixed rent for some time and then increased one etc.

b. No locking of finance:

Since leasing provides 100 percent finance which leads to no lock up of money in capital assets. It helps to ease the flow of working capital of lessee.

c. Less procedure and no delay:

In the case of leasing, ownership of the assset will be with the lessor. Also, disposal of lease proposal takes lesser time than disposal of loan proposal. This helps the lessee to get the required asset within his time frame.

d. Tax factor:

Lease rent is allowed to be deducted against revenue. So, the lessee can enjoy the tax benefits.

e. Technical updation:

Leasing is particularly useful where the technical innovation is very fast. Since the lessee is not the owner he can change into new model or new developed version of any equipment as soon as it comes to market and keep himself updated. Also it provides safeguard against technical obsolescence.

f. No dilution of equity:

The leasing helps the lessee to exercise full control over his project without diluting the equity holding.

g. Off-balance sheet:

The leased asset is not included in the balance sheet. Hence it helps to arrive higher turnover ratos, utility ratios and profitability ratios.

To Lessor:

Leasing offers tax advantage on depreciation. Also, the lessor earns return from day one of the commencement of business, as it does not have any gestation period.

Leasing reduces the risk on the part of the lessor even though the lessee fails to pay the rent. This is possible, because, the lessor is entitled to take back the assets, in the event of lessee fails to pay the rent.

6.3.4 Demerits of Leasing:

Eventhough leasing is considered to be a good source of finance, it does not go without limitations; they are.

a. Compare to debt finance leasing is costiler.
b. The lessee will never become the owner of the asset eventhough he pays total value of thhe asset along with a return to the lessor.

6.3.5 Leasing around the world :

Leasing in the United States of America (U.S.A) :

In the U.S.A. leasing found its way through the development of percentage lease. A barber shop in the Crand Terminal Building was leased out around 1905-1906. The percentage lease found favour during the depression period, since rent was adjusted to the changing economic conditions. Landlords faced with the over availability of vacant property, saw percentage leasing as a method of finding new tenants.8 The concept spread to mineral leases, wherein rental was tied to a percentage of the yield. This type of leasing removed much of the risk in speculation as to mineral resources.

Until sales and lease back type of leasing was developed in 1936, leasing was not recognised as a financial tool in the U.S.

Today, American leasing industry is the largest and it represets about half of the total world leasing. 10 Eighty percent of American

companies and 64 percent of Fortune 1000 companies used leasing to acquire their capital equipment in 1984, costing 74 billion U.S. dollars. Eight out of ten companies use equipment leasing in America, today.

Equipment leasing continues to be one of the fast growing industries in the American economy, according to the 1998 survey of industry Activity, conducted by the Equipment Leasing Association of America (ELAA) formerly known as American Association of Equipment Leasing (AAEL).

Lessors responding to the survey reported 36.8 billion U.S. dollars in equipment as having been added through lease in 1988, an increase of eleven percent over the 33.1 billion U.S dollars inn new equipment added in 1987. this is based on the survey information form 305 member companies, including 80 percent of thhe largest leasing companies in the United States. When brokered business and automative lease transactions are included the 1988 total leasing volume swells to 45 billion U.S. dollars.

The leasing of railway wagon was popular in the U.K. during the nineteenth century. However, the real growth of equipment leasing as it is understood today, began in the early 1960s. In the post-war period there was a considerable growth in consumer finances and in the number of firms offering such facilities. By the late 1950s,as a consequence of increasing regulation to the consumer market, rising competition and availability of funds, a number of finance houses became interested in developing the business credit side of their activities. Leasing had developed significantly both as a method of finance and a sales-aid, during the 1950s in the USA and it was felt that similar opportunities might exist in the U.K. following earlier discussions in the USA, 1960 saw the formation of the Mercantile Leasing Company in the U.K. jointly owned byy Mercantile credit and the United States Leasing Corporation. The incorporation of this company can be said to have market the beginning of modern equipment leasing on a large scale in the U.K. other finance houses and merchant bankers soon followed Mercantile Credit into the leasing market.

Leasing in Australia :

Leasing finance in Australia is a mature financial product having been offered as part of a portfolio of financing techniques for over 40 yeasr. The predominant lessor groups are finance companies and banks: lessees include all private and public sector industries with around 30 percent of the economy's capital equipment being leased.

Leasing in Asia:

The economy of the Asian countries has grown faster in the 1980s than part of any other region. During the period, the Japanese

economy showed a 4.2 percent per annum GDP growth, the economies of 4 NIE's comprising Korea, Taiwan, Singapore and Hongkong, an 8.7 percent and the Thai economy a 9 percent growth while the figure for the world – wide average was 2.5 percent.

Factors contributing to the economy growth of the region are numerous but fast capital investment is the most significant. In 1991, the gross capital formation as a percentage of the GDP was 39 percent in Korea, 37.4 percent in singapoor, 35.5 percent in Thailand, 32.2 percent in Japan, 27.6 percent in Hong Kong, 24.1 percent in India and 23 percent in Srilanka. Leasing has played an important role in the economic growth of the region it being an effective means of financing for business firms in need of funds for capital investments.

Leasing in other countries:

Equipment Leasing was introduced in Germany and Japan during the year 1962. The speedy industrialisation of these countries made leasing a major mode of financing for equipments, plants and machineries.

Almost, in the same period, lesing came to countries like Indonesia, Malaysia and Souht Korea. Here the industry grew at a ranging between 50-100 percent per anum. Europe alone reported an explosive growth estimated at 80 percent during this period.

6.3.5 Leasing in India :

When leasing started gaining momentum worldwide, it had a humble beginning in India, in 1973 with the entry of Madras based First Leasing Company of India Limited (FLCI) of M.A.Chidambaram group of companies. Started with a business of Rs.8.5 crores in 1973-94, Indian Leasing Industry touched a figure of Rs.1,500 crores in 1993-94 and it is expected to reach around Rs. 10000 crores by the turn of this country. The growth has been achieved in several phases as metioned below:

(i) **In the Early 1970s:**

In the late 1960s, the New York – based, First Natioanl Citi Bank did a feasibility study in India for introducing a new concept namely leasing. But it was decided that it was too sophisitcated for the Indian market. The Bank once again tried to introduce Leasing in India in 1971, as a joint venture with State Bank of India, but the attempt failed when Citi Bank insisted on a majority share holding for itself.

In 1973, Farouk Irani, a senior officer in the First National Citi Bank, who developed the concept of leasing in India for the Citi Bank, was quite convinced that leasing had a tremendous future in India and along with Mr. A.C.Muthiah, who belonged to the family of promoters of Southern Industrial Petrochemicals Corporation (SPIC), started the

First Leasing Company of India with a paid up capital of Rs.25 lakhs. The first lease was written for Best and Crompton for Rs.30 lakhs. It took three years to educate their customers. However, the company paid a dividend of 18 percent at the end of thhe second year. Till the end of the 1970s the business grew at a slow pace.

(ii) Rapid growth in the early 1980s:

Attracted by the success story of the First Leasing Company of India and the promising potential, more people entered the field. Twentieth Century was the second leasing company to come into the Indian leasing industry in 1979. Apart from these, there were a few companies like Cholameandalam Finance, Sundaram Finance until 1983.

The growth of Twientieth Century's leasing business was very high during 1980-83. With this good show, Twentieth Century entered into the capital market and came out with an overwhelming response.

(iii) Mushroom growth of Leasing Companies: 1984-86 :

By seeing the performance of the early entrants and the potential of the industry, a lot of organization entered the business. Number of companies increased to about 350 in 1986 from just four major companies in 1983. The capital market witnessed, on an average, atleast two leasing companies coming out with new issues every week. Many factors account for to the mushroom growth of the industry. They are:

a) Unlike the manufacturing industry which has a gestation period of 2-7 years. The investment in a leasing company starts giving yield from they day one. In fact in some cases, the lease rent is received in advance.

b) Lease rent during 1980-83 was around 32 to 35 per thousand per month. This gave a profit rate of more than 50 percent of investment.

c) The cost of capital for the lesaing companies was low and there was no restriction on banks in giving loans to leasing companies.

d) The business led to huge profit, huge dividend and accumulation of reserves.

e) The concept of leasing started gaining popularity in Indian Market. This can be seen from the quantum of business during the period.

f) Leasing created confidence and expectations in the minds of investors.

g) Boom in the stock market during 1985-86 was also another reason for the entry of many leasing companies.

h) Leasing companies were eligible for many tax concession, exemptions and allowances.

(iv) Entry of Public Sector Banks and Financial Institutions:

Moreover, during this period, leasing was recognised as a separate industry. At this juncture the commercial banks were allowed to do leasing through the amend ient of Banking Laws (Amendment) Act, 1983. This was in line with the experiences of many other countries where laws had been changed to make use of funds at the banks and provide insurance for the purpose of leasing. 14 The Banking Law (Amendment) Act, 1983 has amended among other, section 16 and 19 of the Banking Regulation Act 1949, of which the amendment to section 19 is of paricular importance. A part of this section befor amendment read as follows:

"No banking company can form any subsidiary company unless such subsidy company is formed for one or more of the following purpose: (i) undertaking or executing trusts; (2) undertaking of the administration of estates as executor, trustee or otherwise: (3) providing of safe deposit vaults and (4) such other purposes as are incidental to the business of banking provided the previous sanction in writing of the Reserve Bank of India (RBI) had been taken in the behalf.

This provusion was incorporated originally, with a view to preventing banks from carrying on trading activities by acquiring a controlling interest in non-banking companies. After amendment this part of section 19 read as follows:

(a) the undertaking of any business which, under cause (a) to (o) of the sub-section (1) of section 6, is permissible for a banking company to undertake; or

(b) With the pervious permission in writing of RBI, the carrying on of the business of banking exclusively outside India ; or

(c) The undertaking of such other business, which the RBI may, with the prior approval of Central Givernment, consider to bbe conductive to the spread of banking in India or to be otherwise useful or necessary in the public interest "

This enactment enables Indian Commercial banks to set up subsidiaries to transact equipment leasing business and also to invest in shares of equipment leasing companies within specified limits and after obtaining the prior approval of RBI. In principle, banks investment in leasing companies will take the form of portfolio investments. As stipulated, no license is required to promote a leasing company by a bank.

Subsequent to the above amendment, the first bank to enter the leasing industry was the State Bank of India through its wholly owned subsidiary SBI Capital Market Limited on August 1, 1986. Soon the Industrial Development Bank of India (IDBI), the Industrial Reconstruction Bank of India (IRBI) and many other public sector banks and financial institutions came into the business.

The entry of banks and financial institutions boosted the business much among private sector. It is evident that the rapid growth of the aggregable value of assets leased to the Indian Industry, shot up by 100 percent in just over three years. from Rs.75 crores in 1983 to Rs.150 crores in 1985 and crossed the mark of 250 crores in 1986. This is just a flea bite compared to the value of annual investment in industry which was around Rs.12,823 crores in 1984-85 and Rs.75,000 crores during the Seventh Plan period.

(v) **Period of Consolidation (1987-89):**

Every good thing comes to an end. The big wave in the leasing industry during 1984-86 started subsiding in 1987 due to various reasons. They were:

(a) The stiff competition in industry started cutting the lease rent from Rs.32 to 35 per thousand per month in 1983 to Rs.23 to 25 per thousand per month in 1987.

(b) Most of the entrants of 1984-86 were small in size with a capital of around Rs.1 crore to Rs.1.5 crores, which was so much insufficient, that it led to a resource crunch.

(c) The cost of capital also increased rapidly. Only the early entrants who led accumulated good reserves and enjoyed the deposits from the public at a lessor rate and those entered in a big way, could survive in the industry.

(d) The withdrawal of investment allowance was a big jolt to the industry. The main losers on this ground were, in-house leasing companies, created as subsidiaries of the manufacturing companies which were expected to carry on the business of their holding company.

(e) The government's decision to levy minimum tax on all companies, reporting book profits under section 115 j of the income tax Act, 1961, was a big nail in the leasing coffin. This section at the very toot of the scheme of taxation and created, permanent and perennial loss, as allowances, deduction and incentives under the Income Tax Act, were denied.

(f) The 46th Amendment to the consitituion of India empowered the States to levy sales tax on "the delivery of goods on hire purchase or any system of payment by installment". With that the State Government started levying sales tax of about 4 percent.

(g) The leasing insudtry was deprived of concessional Sales tax was available to other assesses who can furnish Form 'c'.

(h) To streamline the accounting system of lessor and lessee the Institute of Chartered Accountants of India(ICAI) came out with a draft or stringent guidelines in February 1987 in the line with the U.K. and U.S. and directed the companies to follow the same from April 1, 1989. These guidelines had not only failed to provide practical suggestion to; suit Indian conditions but also sought to enforce the amendment within four months of its publication giving no lead time at all, whereas even in developed countries a lead time ranging from 2 to 5 years is given to switch over to the new system.

(i) A move by the Reserve Bank of India towards bank finance to leasing companies also hampered the activities of the industry. Reserve Bank put the following restrictions :

(1) The total borrowing by any company should not exceed 10 times the net owned funds.

(2) Bank finance should not exceed 3 times the net owned funds.

(3) The leasing companies can borrow from a maximum of 5 banks only.

(4) For each of the transaction financed by the bank, the maximum amount of drawdown is restricted to 75 percent of the asset cost at the time of accquisition.

(5) Finance will not be available from the banks for lease over a period of 60 months, eventhough leasing companies may enter into such leases

(6) Financing will not be available for sale and lease back transaction, for second hand assets.

(7) Drawing power under the limits will be determined every month from all the transaction by the bank, based on the formula which determines the outstanding credit.

$$\text{Drawing Power} = \frac{\text{Lease rental receivable Over 5 years}}{\text{Total lease rental}} * \text{cost of asset} * 0.75$$

Bad weather affected the industry very much. Moreover, the competition made the new entrants, who were in a disadventageous position, to follow unethical practices. Scarcity in skilled man power made them employ non-professionals. Also, their failure to meet the high expectations of investors, took them away from the scene. At last thhe industry was left with a few geniune companies. Thia act of consolidation made the companies go in for diversified activities instead of doing pure leasing.

(vi) Leasing During Liberalisation in 1991:

The liberlisation process of the Government of India has boosted the total economic activities. The recovery of the auto industry and the the electronics industry from recession has helped the Indian total industry to receive. In this process, leasing also gained very much.

Activities increased in the Fee-based Financial Services like the Coporatory Advisory services, the capital Market Services and the Investment Advisory Services, Seeing the potentiality, most of the leasing companies have diversified or are planning to diversify their action-base.

(vii) Direct entry of commercial banks in 1994:

Dr.Manmohan Singh, the Indian Finance Minister while presenting the Finance Bill for 1994-95, announced that the Government had decided to allow, in principle, the commercial banks to do leasing directly. So far only the subsidiaries of commercial banks had been allowed to do so. While modalities are not worked out with regard to fixation of lease rent, the segment to concentrate and the like, it is expected that banks would concentrate more on big ticket leasing and also fix a lesser lease rent. The industry has welcomed the entry of banks more on ground that his would further popularize the concept and increase the business to around Rs.10000 crores by the end of this century.

Considering the growth and potential of the leasing industry, with the introduction of own-your-wagon scheme of the Railway, government's decision to strengthen power sector and the privatisation of telecom sector, and the like the banks can concentrate on big-ticket leasing.

(viii) Leasing Practices in India:

A) Legislative Frame Work:

a) **Leasing Legislation:** There is no legislation on leasing.

b) **Definition:** There is no legislated definition of leasing. However, the lease contract is a commercial contract that is governed by the general provisions of the Indian Contract Act.

c) **Leasable Assets:** There is no definition of leasable assets, leasing of imported equipment is allowed subject to clearance by the government agencies concerned.

d) **Lease Term:** There is no minimum or maximum term for leasing contract.

e) **Lease Payment:** Lease payment must be expressed in local currency and may be indexed to an inflation indicator or established on a floating rate basis.

f) **Lessee Purchase Option:** Even though no specific law or regulation exists to that efects, the concession to the lessee of a purchase option is not permitted as it will be deemed as hire purchase transactions under the Income Tax Laws.

B) Regulatory Framework:

a) **Regulatory Body:** Leasing activities come under the supervision of the Central Bank to the extent to availing of public deposits, and the Ministry of Finance in the instance of transactions involving inported equipment. The consent of the Security Exchange Board of India (SEBI) is required for the public issues of capital made by leasing companies.

b) **Licence Requirements:** Leasing companies are incorporated under the Companies Act of 1956 and no licence is required to engage in leasing.

c) **Legal Status:** A leasing company may be organized as an individual enterprises, partnership limited liabilty company, corporation or even as a association of persons.

d) **Eligible Lessors:** Besides leasing companies in investment, hire purchase/ finance companies as well as non-finance enterprises may engage inn leasing operations. Already commercial banks are doing leasing through their subsidiaries and now they are permitted to do leasing directly.

e) **Minimum Capital Requirements:** There is no minimum capital requirement, but any leasing company planning to go public with a capital issue must have a minimum share capital of Rs.3 crore.

f) **Ownership:** Foreign ownership in a leasing company is not permitted unless it is speicifically approved by the Foreign Investment Board. Reciprocal ownership of two or more leasing companies is. permitted but a subsidiary cannot acquire shares in the parent company. Ownership of leasing companies by financial institutions is permitted subject to approval by the government departments concerend.

g) **Funding:** Leasing Companies are permitted to accept deposits under the Reserve Bank of India guidelines. The total of such deposits plus all other borrowings, excluding current liabilities, should not exceed 10 times its net worth. Commercial banks have been permitted to provide cash credit facilities to leasing; concerns upto a maximum of 3 time the net owned funds such leasing concerns withih the overall limit of 10 times. The financial insitutions have also come forward to offer medium terms loans exceeding 5 years against the lease receivable of a leasing concern.

Leasing companie may also issue bonds provided they are covered by a charge on the assets and relate to total debt and certain balance sheet rations.

c. Tax aspects of Leasing:

a) Depreciation:

Depreciation is claimed by the lessor since he is the owner of the asset according sec.32 Income Tax Act.

b) Investment Allowance:

Eventhough the Investment Allowance is abolished now, the lessors were permitted to claim the investment allownce.

c) Treatment of lease rent in the books of lessor:

Lease rent will be shown as revenue in the Profit and Loss account of the lessor.

d) Treatment of lease rent in the books of lessee:

Check Your Progress

6. In leasing, Depreciation is claimed by the ______ according sec.32 Income Tax Act.

Since it is an outflow, lease rent is shown as expenditure in the lessee's bokks of account and deducted against revenue.

e) Repairs, maintenace, insurance and other expenditure:

in the financial lease, all these are borne by the lessee. Hence, it is known as expenditure and deducted aginst revenue in the books of lessee.

D) Accounting Standards:

a) Lessor Accounting: Recently, the Institute of Chartered Accountants of India has prescribed a system of accounts for leasing companies.

b) Lessee Accounting: Lessee should Accounts for finance lease contracts by including lease payments in their statements of profit and loss. No accounting standards have been stipulated for the accounting off lessees.

E) Current Market Practices:

a) Residual Value: In most cases, the determination of residual value depends on negotiation between lessor and lessee.

b) Minimum Spread: The minimum spread various widely.

c) Secondary Market: There is no secondary market for the repossessed equipment.

d) Syndicated Lease: The market for syndicated lease is being developed.

e) Off-shore lease market exists at present.

6.6 Equipment Leasing Association :

It will be incomplete if the role of Equipment Leasing Associations, spread all over the world, is not mentioned. Almost, every nation wherever the Equipment Leasing is in practice has an association called Equipment Leasing Association with the name of the respective country at the end. For example, in India there is the Equipment Leasing Association of India and in America, there is the Equipment Leasing Association of America. These associations are independent nature.

In all these associations individual companies or business organisations doing leasing business are accepted as members. The purpose of the association is to have periodical meeting to discuss issues and represent the matter to the right people and get solved to

conduct workship, seminars and training programms for the executive of the member organisations, to conduct surveys and convey the results to their members. Also, they publish in house magazine used by their member and their counterparts outside the country.

These associations have various chapter spread all over the respective countries. Apart from this these associatons are attached to Reginal Associations like Asian Leasing Association Lease Europe and the like.

We have Equipment Leasing Association of India (ELAI), with the Head Office at Madras, formed in 1983. it is the oldest representative trade for the Leasing Industry in India. ELAI has chapters all over the country and it has membership over 125, representing most of the major private sector leasing companies in the country.

ELAI was formed when Indian Leasing started picking up. So it has a role directly or indirectly, in manufacturing the government and regulatory bodies in solving genuine problems of their members. A few such achievements are given below:

1. ELAI made a plea to Reserve Bank of India to direct the Banks to extend the credit facility to leasing companies and also requested the RBI to allow Leasing Companies to accept deposits from the public. In this connection RBI classified the Leasing Company as Non-Banking Financing Company (NBFC) and permitted the NBFC to mobilise resources upto a limit of ten times it s net worth.

2. The ELAI played an active roled in the early 1980s, in getting the benefit of investment allowance replaced subsequently by the investment deposit shemes for the leasing industries.

3. The Association played a major role in making most of its member companies follow the guidelines prepared by the Institute of Chartered Accountants of India.

All these steps have proved vital for the faster growth of the Industry.

Check Your Progress
7. Equipment Leasing Association of India (ELAI), Madras, was formed in the year _______.

6.4 Summary

Leasing companies can play a role as financial intermediaries. They can encourage investment by making funds available in a less cumbersome and spped way. Also, the tax shield from a lease may be reinvested for accelerating growth.

6.5 Keywords used in the lesson

- ✓ Leasing
- ✓ Operating lease and financial lease
- ✓ Leasing in world

6.6 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets, Institutions and Services, 3/e, by
Bharati V. Pathak

6.7 Answer to check your progress question

1. Financial lease
2. 75
3. Leveraged lease
4. International lease
5. Service/Maintenance lease
6. Lessor
7. 1983

6.8 Model Questions

1. What is meant by leasing? Explain various types of leasing.

2. What is a financial lease? How do the income tax aspects affect the lease related cash flow streams of the lessor and the lessee?

3. Examine the various aspects of leasing business in India.

UNIT – 7

HIRE – PURCHASE

7.1 Introduction
7.2 Unit Objective
7.3 Unit structure
7.3.1 Meaning and Charateristics of Hire-purchase
7.3.2 Features of Hire purchase
7.3.3 Development of Hire purchase
7.3.4 Legal aspects of Hire Purchases
7.3.5 Tax Aspects
7.3.6 Framework for Financial Evaluation
7.4 Summary
7.5 Keywords used in the lesson
7.6 Further reading
7.7 Answer to check your progress question
7.8 Model Question

7.1 Introduction

In India, hire-purchase finance had its beginning after the First World War and has since established itself as a reliable supplementary source of finance for purchase of automobiles besides other consumer articles. However, it was only after the Second World War that its growth started assuming visible dimension.

7.2 Unit Objectives

- To know the concepts of Hire-purchase
- To understand the legal and tax aspects of Hire-purchase

7.3.1 Meaning and Charateristics of Hire-purchase:

A hire-purchase can be defined as a contractual arrangement under which the owners let his goods on hire to the hirer and offer an option to the hirer for purchasing the goods in accordance with the terms of the contract. According to the hire purchase Act, 1972, an agreement which fulfills the following conditions is also a hire purchase agreement. (i) the possession of goods is delivered by the owner there of to a person on condition that such persons pays the agreed amount in periodic instalmants; (ii) the property in such goods is to pass such person on the payment on last of such instalment; and (iii) such person has the right to terminate the agreement at any time before the property so passes.

So the two distinct characteristics of a hire purchase are (i) the option to purchase the goods at any time during the term of the

agreement and the (ii) right available to the hirer to terminate the agreement at any time before the payment of the last instalment. Therefore, from the hirer's angle, a hire purchase contract can be compared to a cancelable lease contract with a call (purchase) option.

The call option and the right of termination available with the hirer form the basis for distinguishing a hire purchase transaction from other asset financing plans like instalment sale and conditional sale where the buyer is committed to paying the full price.

A hire purchase differs from instalment sale on one more count. In instalment sale of the ownership of the asset is transferred to the buyer on payment of the first instalment where as in a hire purchase the ownership is transferred to the hirer only when he execise the option to purchase or on payment of the last instalment.

7.3.2 Features of Hire purchase :

The salient features of a hire purchase transaction are therefore as follows:

1. The finance company (the counterpart of the lessor) purchases the equipment supplier and lets it on hire to hire.

2. The hirer is required to make a down payment of 20 to 25 percent of the equipment cost and repay the balance with interest in equited monthly instalments spread over 36 to 48 months either in advance or in arrear.

3. As an alternative to the down payment plan, some finance companies offer a deposit linked plan. Under this plan the hirer is required to invest 20 to 25 percent of the equipment cost in the fixed deposits of the company. In return the hirer it proved with hundred percent finance which has to be repaid with interest in equated monthly instalments spread over 36 to 48 months. On payment of the last instalment, the deposit with accumulated interest is retuned to the hirer.

4. The interest component of each hire purchase instalment is calculated on the basis of a flat rate of interest. The rate of interest charged usually lies in the brand of 13-15% p.a.

5. During the currency of the contract (hire-period), the hirer can opt for an early repayment and purchase the asset. The hirer, exercising this option is required to pay the remaining amount of hire purchases instalments (instalments which have not fallen due) less an interest rebate. The interest rebate is calculated in different ways which are discussed in the following part.

Check Your Progress

1. In ______, sale of the ownership of the asset is transferred to the buyer on payment of the first instalment. 2. Under ________, the ownership is transferred to the hirer only when he execise the option to purchase or on payment of the last instalment.

3. Under Hire-purchase system, the hirer is required to make a down payment of ______% of the equipment cost.

6. Theoretically, the hire can exercise the cancelable option and terminate the contract after giving due notice to the finance company. But in pracitse such terminations are few and far in between because the hirer loses the tax shields on capital allowances (like depreciation) by exercising this option.

7.3.3 Development of Hire purchase

An important development in the area of hire-purchase finance in India took place during 1960's but could not take deep roots. It was the entry of the State Agro-Industries Corporations into the field of hire-purchase finance.

In 1961 in India a study indicated that the following number of surveyed enterprises were offering hire-purchase facilities to their consumers (figure in brackets indicate percentage of total.

Table 7.1
The details of survey

	Offer hire-purchase facility	Do no offer hire-purchase facility	Total
Radio	21 (14)	132 (85)	153 (100)
Electric Fan	1 (8)	11 (92)	72 (100)
Automobile	9 (43)	12 (57)	21 (100)
Refrigerator	-	12 (100)	12 (100)
Machinery	1 (9)	10 (91)	11 (100)

From this study we also get those automobiles dealers were among the major to offer hire-purchase facilities.

Commercial banks entered the field of hire-purchase later than the private hire-purchase financiers. The study referred to above comments about the position in 1964. "From a study of all these the impression that one develops is that the participation of banks in Calcutta in hire-purchase activities is as yet extremely restricted. It was seems that the chief concern of the banks has been caution rather than new opportunities". Banks are prohibited under section 8 of the Banking Regulation Act. 1949 from buying or selling any goods except in connection with the realisation of any loans granted by them or the negotiation of bills. It has therefore not been possible for banks to undertake direct financial assistance to the hirer under hire-purchases contracts. though they have been able to undertake financing

of sale and purchase of goods under instalment credit system. Banks are in effect, doing refinancing of hire-purchase deals.

The Industrial Development Bank of India (IDBI) indirectly paricipates in financing hire-purchase business by way of re-discounting usance bills/promissery notes arising out of sales of indigenous machinery on the hire-purchase basis. Under the IDBI scheme, bills/notes should be drawn in favour of machinery manufacturer who may discount them with banks and other financial institutions. The later, in turn can rediscount the same with IDBI. The period of deferred payment is normally upto 5 years but in special cases, it may be extended to 7 years. Manufacturers of cooton and sugar machinery, machine tools, electrical machinery, oil-solvent extraction plants and agro-industries make use of IDBI facility.

This Industrial Credit and Investment Corporatio of India (ICICI) also run a discounting scheme of usance bills under hire-purchase deals.

Private hire-purchase finance institutions have an important place in the hire-purchase market of India owing to certain charateristics of the hire-purchase business in the country. Commercial banks usually do not give finance for old vehicles, which is done by the private sector companies.

Many Government Committies, such as the Study Group on Road Transport Finacing under the Chairmanship of R.G.Saraya (1968), Study Group on Non-Banking Finance Intermediarise under the chairmanship of Shri B.K.Dutt (1971) and a committee headed by the late James s. Raj and constituted by the Reserve Bank of India (1976) to study the working of Non-Banking Companies have all streesed the need for encouraging this line of financial activity. The James Raj Committee observed that hire-putchase institutions are 'para bankers' and their activity should be further regulated broadly on the lines of the Banking Regulations Act. The Report of the Banking Laws Committee under the chairmanship of Dr.P.V.Rajamannar, while recognising the important role played by hire-purchase companies in the country recommended draft legislation called Personal Property Security Act

Recently, the RBI has allowed banks to enter the business of hire-purchase. The following conditions have been imposed for the purpose:

(1) For the present banks shall not themselves undertake directly (i.e. deparmental ;) the business of hire-purchase.

(2) Banks which have set up subsidiaries (i.e company in which it holds not less than 51% of the shares) for undertaking the business of equipment leasing, merchant banking, etc. may

undertake the hire-purchase business either through such a subsidiary ot through a separate subsidiary. Other banks may set up subsidiaries to transact hire-purchase business either exclusively or together with the business of equipment leasing. Banks desirous of undertaking hire-purchase business through an existing or new subsidiary as above, will require the prior approval of the Reserve Bank of India in order to do so and they should apply to the Chief Officer, Department of Banking Operations and Development, Central Office, Bombay.

(3) While banks may invest in shares of other hire-purchase companies within the limits specified in the Banking Regulation Act, 1949 with the Reserve Bank's prior approval they shall not act as promoters of such companies.

(4) An existing bank subsidiary that may hereafter transact hire-purchase business or a new subisidiary set up to transact such business, as provided in clause (2) above shall not engage itself in the financing of other companies or concerns engaged in hire-purchase business.

(5) Investment of a bank in the shares of its subsidiary / ies set up for undertaking equipment leasing and/or hire-purchase business, together with the invesment of the bank in shares of other companies carrying on equipment leasing and/or hire-purchase shall not in the aggregate exceed to per cent of the paid – up capital and reserves of the bank.

(6) Any application to be made to the Controller of Capital Issues, in connection with setting up of a new subsidiary or for a subsequent issue of capital shall need prior clearances from the Reserve Bank of India.

(7) Banks setting up a subsidiary for the purpose of carrying on hire-purchase business through their existing subsidiaries should furnish such information in such form and at such time as the Reserve Bank may require time to time.

7.3.4 Legal aspects of Hire Purchases:

As on date there is no legislation that exclusively deals with hire purchases transactions. Although the Hire purchase Act was passed in 1972, it has so far not been enforced. In 1989 and Amendment Bill was introduced to amend some provisions of the hire purchase act. It is expected that the amended version of the Act will be made operational in the near future. (The reader is required to note that the amendments discussed in the earlier section are the amendments proposed by the bill).

Check Your Progress
4. Hire purchase Act was passed in the year ______.

The Hire Purchase Act 1972 (Refer Appendix 8B for the Bare Act) has provisions for regulating.

1. Format and Contents of the Hire Purchase Agreement.

2. Warranties & conditions underlying the Hire Purchase Agreement.

3. Ceiling on the Hire Purchase Charges (Total charge for credit).

4. Rights and obligations of the hirer and the owner.

However in the present context where the aforesaid Act is not operational the legal aspects of the hire purchase transaction have to be as certained from the relevant provisions of the Indian Contract Act, 1872, the Sale of Goods Act, 1930 and the judgements pronounced by the courts on issues related to these types of contracts.

The salient legal aspects of hire purchase transactions are as follows:

1. Under a hire purchase contract the owner has the obligations;

   i. He must have a title to the goods let on hire at the time of delivering the goods.

   ii. He must ensure that the hire has quiet possession of the goods and his quiet possession is not tampered with either by himself or by the lawful acts of third parties.

   iii. He has to deliver possession of the goods to the hirer because the hiring does not commence until the goods have been delivered (The place of delivery can be the place of business of the owner).

   iv. He has to ensure that the goods are of merchantable quality and that they are reasonably fit for the purpose for which they are used. The obligation relating to ensuring fitness arises only where the hirer has made known to the owner thhe particular purpose for which the goods are required.

   v. Where goods are let by description the owner to ensure that the goods actually let on hire answer the description. Similarly in cases where the goods are let by references to a sample, the owner has to ensure that the bulk corresponds with the sample and also afford an opportunity to the hirer to compare the bulk with the same.

2. Under a hire purchase contract the hirer has the following impiled obligations: (i) the hirer have to take a reasonable care of the goods. (ii) The hirer cannot sell the goods or pledge them or use them for a prupose different from that stipulated in the contract during the currency of the contract. (iii) The hirer must pay the sums stated in the contract at the specified points of time and in the manner prescribed by the contract. The reader is required to note that in the absence of any express provision to the contrary, the time of payment is not regarded as the essence of the contract. Therefore, some occasional delays in payment over the hire period do not empower the owner to terminate the contract unless the default(s) can be linked to an intention on the part of the hirer to reudiate the contract.

3. Apart from the implied obligations of the hirer, the hire purchase agreement expressly imposes certain obligations on the hirer: (a) He is required to arrange for a comprehensive insurance cover for the goods hired. The cover can be taken in the joint names of the owner and the hirer or in the name of the hirer baering an indorsement recording the owner's interest in the goods. The hirer is required to pay the insurance premiums and do everything that is necessary to keep the insurance policy in forcr. (b) He is required to indemnify the owner against any loss or damage, (c) He has to obtain all permits and consents necessary for the usage of goods and not contravene any law or regulation that has a bearing on the usage of the asset. (d) He is required to bear all costs incurred in connection with maintaining the goods in serviceable condition.

4. Usually a hire purchase agreement provides for the owner's right for repossession of the goods upon breach of the hire purchase agreement by the hirer. The courts have held that in the absence of a specific enactment governing hire purchase transactions the owner is entitled to repossess the goods through means specified in the hire purchase agreement and in the process he is entitled to use such physical force as may be necessary.

5. A hire purchase agreement usually provides for (i) the right of the hirer to determine (terminate) the hire purchase contract at any time before the final payment and (ii) the right of the hirer to purchase goods at any time before the final payment. In the former case, the agreement provides for the mode of terminating the contract and in the latter case, it provides for the method to be followed for calculating the interest rebate

6. Since the owner, in a typical hire purchase transaction is a finance company which doesnot deal in the class of goods that are let on hire, usually are implied obligations of the owner stated in (iv) and (v) of (1) are not relevant. To prevent the possibility of the hirer involving these implied conditions and exclusion clause is included in the hire purchase agreement which states that no liability can be attached to the owner if (i) the good are not of the merchantable quality; (ii) the goods are unfit for the particular purpose for which they are required; (iii) the goods fail to correspond with the description; (iv) the bulk doesnot correspond with the sample ; and (v) there is a violation of the conditions, warranties or representatives made by a dealer or a supplier (provided the dealer or the supplier is not acting as an agent of the owner).

7. One of the legal issues relating to a tripartite hire purchase transaction is the legal relationship between the hirer and the dealer (or supplier). Clearly, there is no direct contractual relationship between the hirer and the dealer. The question is: can the hirer hold the dealer liable for the express warranties made by him? There is no legislative provision which says 'yes'. But there are some English case laws which state that when the hirer has entered into a hire purchase contract placing reliance, quality or quantity of goods, it gives rise to collateral contract between the hirer and the dealer and the hirer is entitled to claim damages for breach of warranty comprised in the collateral contract.

7.3.5 Tax Aspects:

The tax aspects of hire purchase cab be divided into three parts: Income Tax, Slaes Tax and Interest Tax aspects.

1 Income Tax Aspects:

The treatment of a hire purchase transaction from the Income-tax angle is governed by the provision of CBC circular way back in 1943.

According to this circular, the hirer is entitled to (a) the tax shields on the consideration for hire with reference to the cash purchase price: and (b) the tax shield on the consideration for hire (total change for Credit). The circular defines consideration for hire the way we have defined the total charge for credit and requires this amount to be spread evenly 5 over the term of the agreement. From the

owner's angle the consideration for hire received by him is liable to tax.

The reader familiar with the provisions of the Income Tax Act governing depreciation can see a conflict between the contents of the CBCT circular and the relevant provisions of the Act. The Section 32 of the Income Tax Act states that an assessee can claim depreciation on business assets if and only if (i) the assets are owned by the assessee; and (ii) the assets are used for the purpose of the business of the assessee. In a hire purchase transaction the hirer is not the legal owner until he exercises the purchase option. Thus there is an apparent inconsistency in permitting the hirer to claim depreciation. This inconsistency had resulted in some litigation in the past. But in such cases the courts had upheld the provisions of the circular issued by the CBCT.

While we are on this subject, we must also make a mention of the controversy relating to deduction of tax at source from the consideration for hire paid to the owner. Section 194a of the Income Tax Act requires every assessee (other than an individual and a HUF) to deduct tax at source on interest payments made to residents at the prescribed rate. Since for all practical purposes, the hire purchase is an asset financing plan, the question that naturally arises is : Can consideration for hire be treated as interest payment and tax deducted at source? Based on the form of contract one can argue that considerationfor hire represents renting charges. On the other hand based on the substance of the contract one can argue that the consideration represents "interest". In 1981 the CBCT issued a circular clarifying its stand on the issue. According to this circular the provisions of Section 194A of the Income Tax Act are not applicable to the consideration for hire paid in respect of hire purchase contracts which expressly provide for the option fo purchasing the goods at any time or of returning the same before the total amount is paud. Does the circular imply that consideration for hire in respect of other hire purchase contracts (contracts which do not expressively provide for the aforesaid iptions) must be paid after deducting tax at once? The answer continues to be exclusive.

1. Sales – Tax Aspects:

The sales tax aspects of hire purchase contracts have to be gleaned from the provisions of the Consitutions (Forty – Sixty Amendment) Act, 1982 and a maze of high court and Supreme Court rulings on the subect. The salient sales – tax aspects are as follows:

1. Hire purchase transaction per as are liable to Sales-tax. The Forty Sixth Amendment Act clearly states that the tax on the sale or purchase of goods includes a tax on the delivery of goods on hire purchase or any other system of payment by instalments.

2. For the purpose of levying sales-tax a sale is deemed to take place only when the hirer exercises the option to purchase.

3. The amount of sales-tax must be determined with reference to the depreciated value of the goods at the time when the hirer exercises the purchase option. The appropriate method for computing the depreciated value is to be determined by the sales-tax authorities.

4. The state in which the goods have been delivered (to the hirer) is the state entitled to levy and collect sales-tax.

5. Sales tax on hire purchase will not be levied if the state in which the goods are delivered has a single point levy system in respect of such goods and if the owner (finance company) had purchased the goods within the same state.

6. Sales-tax cannot be levied on hire purchase transactions structured by finance companies provided these companies are not dealers in the class of goods let on hire.

7. There is no one uniform rate of sales-tax applicable to hire ourchase transactions. The rate varies from state to state.

3 The Interest – Tax Aspects:

The Finance Act, 1991 has amended and re-introduced the Interest-Act 1974 with effect from 1.10.1991 which provides for imposing a special tax on interrest earned by a credit institution. Credit institution as defined under this Act includes a hire purchase finance company, that is to say, a company which carries on, as its principal business, hire purchase transactions or the financing of such transactions. The salient provisions of this act as follows.

1. Interest tax is payable on the total amount of interest accruing to a hire purchase company in the previous year (Chargeable Interest) at the rate of three percent.

2. The amount of interest which is established to have become a bad debt during the previous year can be deducted from the chargeable interest.

3. The interest tax payable by the hire purchase company will be treated as a tax deductible expense for the purpose of computing the taxable income under the Income Tax Act.

The relevant extracts from the Interest Act, are reproduced the appendix 8D.

4. Accounting Aspects

I.In the Books of the Hirer:

The accounting mechanics from the hirer's angle as follows:

1. The cash purchase price of the asset is capitalized and the capital content of the hire purchase instalments (the cash purchase pric less the down payment) is recorded as a liability.

2. Depreciation is charged on the cash purchase price of the asset in line with the depreciation policy pursued by the hirer with regard to other owned assets.

3. The total charge for credit or the unmatured finance charge at the inception of the hire purchase transaction is allocated over the hire period using one of the following methods:

- Effective Rate of Interest Method.
- Sum-of-the Years Digits (SOYD) Method.
- Straight Line Method.

(ii) In the Books of the Finace Company:

In the books of the finance company, (owner) the accounting treatment will be as follows:

1. At the inception of the transaction, the finance company records the hire purchases instalments receivable as a current asset (stock on hire) and the (unearned) finance income component of these instalments as a current liability under the head "Unmatured Finance Charges".

2. At the end of each accounting period, the finance company recoginses an appropriate part of the "Unmatured Finance Income" as current income of the period. The methods that are followed for allocating the unmatured finance income over the relevant accounting periods are the ones we are familiar with – Effective Rate of Interest Method, SOYD Method and Straight Line Method.

3. At the end of each accounting period, the hire purchase price less the instalments received is shown as a receivable (stock on hire) and the finance income component of these instalments is shown as a current liabbility (Unmatured Finance Charges).

4. The direct costs associated with setting up the transaction are either expended immediately or allocated the finance income over the hire period.

7.3.6 Framework for Financial Evaluation:

In the first part of this section we will evaluate the economics of a hire purchase transaction vis-à-vis a finance lease from the hirer's poin of view. In the next part, we will discuss the same aspect from the standpoint of the finance company.

The Hirer's Angle:

From the hirer's angle, the financial evaluation will involve the following steps:

Step 1: Define the cost of hire purchase (COHP).

COHP = Down Payment + P.V. (hire Payments discounted at kD) + Service Fee – P.V. (Depreciation Tax Shields discounted at kC) – P.V. (Salvage Value Discounted at kC) (Equation 1).

Step 2 : Define the cost of Leasing (COL)

COL = Lease Management Fee + P.V. (Lease Payments discounted at kD) – P.V. (Tax Shields on Lease Management Fee and Payments discounted at kC) +P.V.(Innterest Tax shields on Displaced Debt discounted a kc) + P.V. (Differential Interest Tax shields associated with H.P discounted at kc) (Equation 2)

Step 3: Compare COHP with COL

A. If COL exceeds COHP. Hire Purchase is to be preferred.

B. If COL is less than COHP, leasing is to be preferred.

The Equations 1 and 2 can be rewritten as :

COHP = Down Payment + P.V. (Hire Payments) + Service Fee – P.V (Tax shields on Hire Payments & service fee) – P.V. (Tax shields on depreciation) – P.V (Net Salvage Value) (Equation 3)

The Finance Company's Angle:

From the standpoint of the finance company (the financilal intermediary), the evaluation of a lease plan vis-à-vis a hire purchase plan boils down to a comparision of the NPVs of the two plans which can be defined as follow :

NPV (Lease Plan) = Initial Investment – Initial Direct Costs + P.V (Lease Rentals) + Lease Management Fee + P.V (Tax Shields on Initial Direct Costs & Depreciation) + P.V. (Net Salvage Value) – P.V (Tax Liability on Lease Rentals and Lease Management Fee) (Equation 4)

NPV (HP Plan) = Loan amount – Initial Direct Costs + Documentation & Service Fee + P.V (HP Instalment)- P.V (Interest Tax on Finance Income)- P.V(Income Tax on Finance netted for interest Tax) + P.V (Tax Shield on Initial Direct Costs) - P.V (Income Tax on Documentation & service Fee) (Equation 5)

The plan with the higher NPV is the plan which is financially more attractive.

7.4 Summary:

1. Hire Purchase can be defined as a contractual arrangement under which the owner lets his goods on hire to the hirer and offers an option to the hirer to purchase the goods in accordance with the terms of the contract. The two distinct features of a hire 'purchase transactions are: (1) the option provided to the hirer to purchase the goods at any time during the term of the arrangement; and (2) the right available to the hirer to terminate the agreement at any time before the payment of the last instalment. Hire purchase plans can be of two types : (i) Down Payment Plan and (ii) Deposit Linked Plan.

2. The rate of interest quoted on a hire purchase transaction is always a flat rate. To convert the flat rate (F) into the effective rate (i) under a Down Payment Plan we can use the following approximation formula :

i = n / n+1 .2F where no denotes the number of repayments

If the instalments are payable at the beginning of each period, the relationship between i and F is given by the formula:

i = n / n-1 .2F

3. In the case of deposit linked plan the effective rate of interest is calculated as follows: (a) The Cashflows over the relevant periods are defined. (b) The Rate of interest which equates the P.V of the cashinflows to the P.V of cash outflows is calculated. This rate of interest reflects the effective rate of interest implicit in the plan.

4. If the hirer exercises the purchase option before the payment of the last instalment, then the amount to be paid by him will be equal to the aggrgate amount of the outstanding hire purchase instaments less an interest rebate. The true interest rebate can be calculated using the Effective Rate of Interest Method. Alternatively it can be calculated as per the Rule of 78 given by the formula :

$$R = t(t+1)/n(n+1) \quad * D$$

Where R = Interest rebate

t = number of instalments outstanding

n = total number of instalments and

D = total charge for credit

The interest rebate calculated under the Rule of 78 will be always less than the true interest rebate.

5. As far as the legal aspects are concerned, the Hire Purchase Act, 1972 provides a comprehensive coverage. But since this Act has been operationalised the legal aspects of hire purchase transactions are governed by the provisions of the Indian Contract Act, 1872 sale of goods Act 1930 and the judgements pronounced by the English and the Indian Courts from time to time.

6. The income tax aspects of hire purchase transactions are governed by the provisions of a circular, the hirer is entitled to the tax shields on (i) depreciation calculated with reference to the cash purchase price of the asset; and (ii) the consideration for hire or the finance charge component of the hire purchase instalments. The circular provides for an even allocation of the total finance charge over the term of the hire purchase agreement.

7. As per the 46th Amendement to the cosititution the hire purchase transactions are eligible to sales tax. However there are court rulings which the state that hire purchase transactions structured by finance companies (not dealing in the class of goods let on hire) are in essence financing transactions and therefore not liable to sales tax.

8. The finance Act, 1991 reintroduced the interest tax Act, 1974 which provides for an interest tax at 3 percent on the interest income implicit in H.P.transactions.

9. From the hirer's standpoint the financial evaluation of a hi purchase vis-à-vis a lease is done by comparing the costs · hire purchase (COHP) and lease (COL) are defined as follows:

COHP = Down Payment + Documents & service chrages + P.V (Hire Purchase Instalments discounted at kj) – P.V. (Depreciation Tax Shields discounted at Kc) – P.V. (Net Salvage Value discounted to kc) – P.V. (Interest Tax Shields discounted at kc)

Where kd = Pre – tax marginal cost of debt.

kc = Post-tax marginal cost of capital

COL = P.V. (Lease Payments discounted at kd) – P.V. (Tax Shields on Lease Payments discounted at kc)

If COHP exceeds COL the asset must be leased, otherwise it can be acquired under the hire purchase plan.

10. From the finance company's point of view, the financial evaluation will invlove companing the net present values (NPV) of the two assets based financing plans. These NPVs are defined as follows:

NPV (Finance Lease) = - Initial Investment – Initial Direct Costs + Lease Management Fee + P.V (Lease Rentals) – P.V (Tax on Rental Income) – P.V (Tax on Lease Management Fee) + P.V (Tax Shield on direct Costs) + P.V (Tax Shields on depreciation) + P.V (Net Salvage Value)

NPV (Hire Purchase) = - Initial Amount – Initial Direct Costs + Documentation & service Fee + P.V (Tax shield on Direct Costs) – P.V. (Tax on Documentation & service Fee) + P.V (Hire Purchase Instalments) – P.V. (Income Tax on Finance Income) – P.V (Interest Tax on Finance Income) + P.V (Tax Shield on Interest Tax)

The discount rate is used is the marginal cost of capital of the company. If NPV (Finance Lease) exceeds NPV (Hire Purchase) the finance company must have a product mix weighed in favour of leasing, otherwise the product mix must be slanted in favour of hire purchase. In practice NPV (Hire Purchase) tends to exceed NPV (Lease).

11. A hire purchase transaction is reflected in the books of accounts of the hirer as follows: (a) The cash purchase price of the asset is capitalized and an amount equal to the cash purchase price less down payment is recorded as a liability. (b) Depreciation is

charged on the cash purchase price in line with the development policy pursued by the hirer for similar owned assets. (c) The total charge for credit is spread over the accounting periods (constituting the hire terrm) based on one of the following methods: (1) Effective Rate of Interest Method, (2) Sum of the years Digits Method or (3) Straight Line Method.

10. In the books of the finance company, the hire purchase instalments receivable is shown as current asset under the head 'Stock on Hire' and the (unearned) finance income component of these instalments is shown as a current liability under the head "Unmatured Finance Charges". The unearned finance income is spread over the accounting periods using one of the methods listed above. The direct costs associated with the transaction is either expensed immediately or suitably amortized over the relevant accounting periods.

7.5 Keywords used in the lesson

- ✓ Hire purchase
- ✓ Tax aspects of Hire purchase

7.6 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets, Institutions and Services, 3/e. by

Bharati V. Pathak

7.7 Answer to check your progress question

1. Instalment
2. Hire-Purchase
3.20 to 25
4. 1972

7.8 Model Questions

1. Define hire purchase. List the major differences between a hire purchase and an instalment sale.

2. List the salient features of a typical hire purchase transaction.

3. Discuss the implied obligations of the hirer and the owner in a hire purchase transaction.

4. Explain the legal issue(s) involved in the triangular relationship between the equipment supplier, the finance company and the hirer.

Problems :

1. Under the hirer purchase plan of Nidhi Finance Company (NFC), the amount of each hire purchase instalment is calculated on the basis of a flat rate of interest of 14% p.a. the typical repayment period is 3 years and the freaquency of payment if monthly in advance. Calculate the effective rate of interest per annum.

2. Under the deposit linked hire purchase plan of Uma Financial Services (UFS), the hirer is entitled to hundred percent finance against a security deposit equal to 20 percent of the amount finance. The hire term is three years and the instalments are payable monthly in advance. UFC charges a flat rate of interest of 13 percent p.a and a front ended documentation fee equal to one precent of the loan amount. An amount equal to 2 percent of the loan amount is offered as rebate for prompt repayment. Interest on the security deposit is calculated at the rate of 15 percent per annum compounded quarterly and the accumulation is returned to the hirer after three years. Assuming that the hirer will avail of the rebate for prompt repayment. calculate the effective rate of interest per annum from the hirer's point of view (Assume 360 days to a year).

3. The salient features of the hire purchase plan of Udhayam Financial Services (UFS) is as follows:
Down Payment: 25 percent of the investment outlay.
Repayment Period: Four Years.
Frequency of Payment: Monthly in advance.
Flat Rate of Interest: 14 percent per annum.

Doccumentation & services Fee (front ended) : 0.5 percent of the investment outlay.

Rebate for prompt repayment: One percent of the investmment outlay.

A hirer who just paid the 24th instalment wants to exercise the purchase option provided by the hire purchase contract.

i. Calculate the interest rebate available to the hirer if UFS calculates the interest rebate according to (a) Actuarial Method, (b) Rule of 78 Method and (c) Straight Line Method.

ii. In cases of early repayment, UFS follows (a) the practice of granting a rebate of one percent of the aggregate amount of instalments paid till date as rebate for prompt repayment; and (b) the modified rule of 78 with a two month time lag for calculating interest rebate. Calculate the effective rate of interest per annum implied by the completed transaction. Is it higher than the effective rate of interest per annum implied by the plan?

UNIT – 8

VENTURE CAPITAL

8.1 Introduction
8.2 Unit Objective
8.3 Unit structure
8.3.1 Meaning and Definition of Venture Capital
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8.3.4 Raising Venture Capital
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8.8 Model Questions

8.1 Introduction

Venture capital means long term funds to finance high technology projects which have an inherent risk factor, but which hold promise of high profitability and growth.

8.2 Unit Objectives

- To understand the concepts of venture capital
- To know the procedure for raising venture capital

8.3.1 Meaning and Definition of Venture Capital:

Broadly defined, venture capital denotes financing all stages of a corporate development cycle. However the term is more popularly used to financing of high technology, high risk and high growth ventures. Venture capital therefore is patient long term and risk reward sharing in nature. The distinguishing features of venture capital investments are

i) It supports and nurtures entrepreneurial talent by providing finance and business management skills. The venture fund/company is an active participant in the project rather than a passive one.

ii) It is mainly an equity or quasi equity participation.

iii) Support is given to both start ups as well as existing companies for commercialization of business ideas which are innovative and technology intensive and

which display potential for significant growth and financial return.

iv) The investment is long term in nature.

v) Returns through long term capital gains.

vi) Requires patience for project maturing.

Venture capital institutions attempt to perceive the talent potential for growth in a particular sector of activities and invest with a view to getting a higher yield on the investments. The term "High Technology" has no fixed definition but is viewed in relation to the period of time on Market and geographical environments. A venture capitalist would be attracted to a project with innovative content, the innovation being a product innovation or innovative marketing. "High Tech" projects could mean those projects, which by virtue of newly developed process/product designs lead to

i) substantial reduction in cost of production and / or

ii) increased productivity and / or

iii) improvement in quality of end product

iv) Significant value addition, consequently leading to higher returns.

The venture capitalist seeks investment opportunities in projects laden with commercial risk, technological risk or both. Investments are sought in chosen market sectors and value added by active on going management involvement and further staged fnancing until the investment matures.

Innovative hitech ideas are necessarily risky. Such projects with uncertain outcomes involving a high mortality risk and gestation period but with expected high accretion to the investment if the technology succeeds are considered favourably by venture capitalists. What is more important is whether the technology is futuristic and relevant to the country, and whether it can not only withstand the market competition but also contribute to the effective utilisation of the nation's resources.

In short, Venture Capital is an investment finance instrument directed towards encashing the opporuinities arising out of conductive atmosphere in stock market with a focus on growth of small and medium sector with technological/market innovation

Check Your Progress

1.Venture capital is provided for __________.

2.The venture capitalist seeks investment opportunities in projects laden with ___________and

Venture Capital vs. Conventional Financing:

Venture capital differs from conventional financing thus,

a) Fiscal support is offered as equity not as loan

b) Yield is derived from capital appreciation and dividends nor interest

c) While traditional financing concentrates on current income but the venture capital financing focuses on capital gains.

d) Conventional financing concentrates on single round financing as against need based support at all stages of growth provided by a venture capitalist.

e) A venture capitalist retains tighter control over management than a lender.

What is characteristic of venture capital is active management involvement and financing participation until the project reaches a mature stage.

8.3.2 Objectives of Venture Capital :

As already earlier the objective of venture capital funds is to generate substantial capital appreciation through investment in early stage companies capable of achieving rapid growth the relatively high being compensated by the promise of capital gains. Venture capital would support the following phases of a company's lifecycle.

a) From product concept to product development.

b) Commercial scale implementation.

c) Post commercialization during initial period of teething troubles, negative cash flows, expansion and

d) Turnaround of sick units.

The aim being promotion of technological advancements through product/process creation and novel ideas/strategies. the stress is on indigenous technology. However foreign know how suitably adapted to Indian conditions will also be supported. The list of eligible activities is available in our brochure.

Venture capital financing could come in the following forms:

a) Seed capital

b) R & D financing

c) Startup capital

d) Early stage finance

e) Second round finance

f) Expansion capital-machine financing

g) Turn around financing

Criteria for Venture Capital Investment:

A high degree of selectivity governs the choice of proposals for venture capital investments. The essential requisites are:

a) A competent, professional entrepreneur/management team.

b) Feasibilty of the proposal from the technical, commercial and marketing angles.

c) Long term competitive advantages available to the company.

Venture Capital R & D Perspective:

Utilisation of technology for better management of a country's resources will depend to a large extent on the stage of its R & D efforts. Even for adapting new technology from outside to the local conditions, in house R & D has to be effective.

Commercially, viewed technology means some eauipment or processes that convert raw material to finished goods or some services leading to value addition. While the ability to innovative may exist, the ability to commercialise innovations is the most challenging task. By "commercialising innovation", we mean transfer of new technologies from research laboratories to the market place in the form of products.

Large business does not have their own research and development division for product/process creation but also the financial resources to support experimantal ventures. The medium and small business are largly unsuccessful in obtaining finance from traditional bankers/financers for start up or development projects with

high attendant risk of failure. Venture capital institutions would like to address themselves to this segment including in commercial exploitation of product/process ideas. This activity is undertaken both by first generation technocrat entrepreneurs and by in house R & D outfit existing business in the field.

8.3.3 Venture Capital in India :

Venture capital is a recent development in India and has been borrowed from western industrialised countries where the venture capital industry has taken firm roots.

The rapid and phenomenal success of Venture capital in the United States and its contibution to its technological process have soread the concept to Europe, Japan, Australia, New Zealand and more recently to the developing countries of Asia including India. Venture capital financing has now come to occupy a significant place in the financial system. It is the driving force behind the profirable commercialisation of technical innovations by small enterprises, which otherwise would not have access to appropriate institutional funding.

The need for venture capital financing in the Indian context arises out of inadequate means of financing skill or technology intensive projects. New technocrat entrepreneurs who have broad commercial propositions or in the form of new product or services, are not able to embark on their enterprises owing to inadequacy of capital. New technology developed in laboratories or which is to be developed in a laboratory requires substantial risk finance. Foreign technology could also be sought to be commercialized in a developing country like India where markets are not yet saturated.

Approaching the public directly for subscription will extra along with the constant fear of a takeover from a corporate predator. Besides for new companies the public responses may not be forth coming and hence it may be difficult to enter the capital market without a good track record. The fact that the technology is new, untried and risky makes it an unattractive proposition to risk adverse traditional financiers. Venture capital fulfils the need of such high technology business for financing growth oriented propositions.

The concept of venture capital as financial service in India was introduced in the fiscal budget for the year 1986-87. When a bill was introduced for levying a 5% less on all know how import payments to create a pool of funds for venture capital activity by IDBI. In the same year, ICICI also commenced venture capital financing in a small way. In November 1988, the Govt. of India issued the venture capital guidelines.

Check Your Progress
3. The concept of venture capital as financial service in India was introduced in the financial year _____.
4. ICICI commenced venture capital financing in the year_____.

8.3.4 Raising Venture Capital :

The following are the details required to the furnished by the entrepreneur while approching venture capital firm for assistances.

Preparing a business plan:

Every venture capital, whatever its investment objectives, will ask for satisfactory answers to the following basic questions when approached by a potential invested company:

a) How much do you need. over what period and how will the money be used?

b) How and when will you pay the money back?

A business plan answers these basic questions. Therefore, in its true sense, it is partly a plan and partly a history of the company.

The business plan tells a story about the business, its people, its financial aspects and projections and talks about the reinvestment or repayment of funds. The business plan may contain the following standard sections.

(i) Executive Summary:

The Executive Summary is important as it gives venture capitalists an initial impression of the company. It is short and compelling review of the strengths of the business and management and the plan for use and return of the funding sought. Every point of the executive summary should be covered in detail in the main sections of the business plan.

(ii) Product / Service:

Here one should describe in details what product or service you currently provide or plan to provide. Unique features of the product or service should be emphasized and described as to why the product is better than other competitor's which are selling on the market. One should also describe the pricing policies of the product.

In addition one should in broad fairly non-technical term, present the status of the product's or service's development so that someone reasonably familiar with the technology or the industry can understand it. This discussion should include.

- Product.
- The track record of the key people in developing similar product

- Propriety aspects of your technology and
- Reasons why this product is more advanced or better than existing technology products or services.

(iii) Market analysis and marketing strategy:

The business plan must also assess market potential. Many good products are never properly commercialized (and many bad ones slip through) because their inventors do not stop analyze the market potential.

The market analysis, therefore, should be as specific as possible, focusing on fact based, reasonable and attainable projections. The analysis should include:

- Size of the potential market and market niche pursued.
- Market share anticipated.
- Description of the competition (who, what and how many)
- Marketing channels-current and expected
- Who and where the potential customers are
- The possibility of related or new markets that can be developed.
- The marketing strategy also needs to be detailed in this section. To the venture capitalist the marketing ability is an important as the ability to develop the product itself. This should cover.
- Specific marketing techniques planned in other words, how the company will identify, contact and sell to potential.
- Customers.
- Pricing plans: how will the value of the product be demonstrated
- Planned sales force and selling strategies for various accounts and markets
- Customers-how many there are and where they are located

- Customer coverage and service which markets will be covered by direct sales force, which by distributors, representatives or resellers.

- Specific approaches for capitalizing on each channel and how they compare with other practices within the industry and

- Advertising and promotional plans.

(iv) Operations:

The business plan should go on to outline your plans for operations. This section should cover for example, development, early manufacturing, market development, first product installation as well as facilities, work force by job category, extent of subcontract, sources of supply, warranty and service strategy and/or by department for a specific period of time. This analysis will not only allow to better plan hiring and recruiting but will also demonstrate to potential investors the sensitivity of your plans to the hiring of the key personnel.

(v) Management Team:

Venture capitalists invest in people as much as they invest in a product or a company. This section of the business plan should. therefore introduce the members of the management team (at least the five top key people)

Highlights of their track records and detailed resumes for each of these people should be included as an appendix to the business plan.

(vi) Risk factors:

Every business will have risks, even if just the risk that the projections may be a bit off. This section should identify and list the major problems and pitfalla that the company may encounter and discuss them in detail.

The common risk factors faced by a company include:

- A change in industry growth vis. Assumptions,

- A change in competitive pricing vis. Assumptions

- Difficulties in obtaining parts and raw materials

- Difficulties in achieving product development schedule

- A change in market structure (e.g a new entrant or a new technology) and

- A change in the availability of appropriately priced and trained labour.

(vii) Funds Requested:

This section sets forth the entrepreneur's objectives in terms of capital to be raised. It should mention an amount (or large of amounts) and touch on the tissue of type of security offered, currency, disbursement schedule, etc.

(viii) Return on investment and exit:

This section addresses the final basic question the venture capitalist will want answered how will you provide him with a return on his investment in the company?

An IPO and other possible exit strategies should be contemplated and described in the business plan. Additionally the timing and expected return of the investments should be discussed in detail.

The entrepreneur should be prepared to address this issue with the venture capitalist. At the same time, this section may also cover prospects for investment in new ventures and opportunities for the venture capitalist to increase his stake in the company.

This section describes how the capital raised will be used. A proposed disbursement schedule (i.e. of funds from the venture company to the investee) may also appear here.

(ix) Financial Summaries:

The core of any business plan is the section on historical financial data about the company and the finance forecasts. At least three financial forecasting elements should be provided.

- An operations forecast showing outlay for materials, payroll overhead, rent, utilities, shipping and other administrative costs.
- A cash flow projection displaying where money will be coming from and going to and showing how much cash will be coming from sales, accounts receivable, loans, additional capital and contributions by the owners. Ideally also shown would be how much and when cash will be expanded for business costs, equipment purchases, loan repayments and other major cash outlays and
- A balance sheet displaying assets, liabilities and net equity of the business at various times

All three forecast financial statements should include 12 monthly projections and annual projections for the next several years. Since most venture capitalists will take the time to study such forecast documentation extremely closely, creditability is important.

In most cases it is advisable to draw up additional sets forecasts based on worst case/best case Scenarios to assure the venture capitalist that downside risk can be and has been adequately planned for.

As part of these financial projections one should highlight the proposed investment including the desired amount of financing a summary of the use of the proceeds, the security instruments being offered and the terms and pay back.

8.4 Summary

Venture capital is risk financing available in the form of equity or quais-equity. A venture capitalist also provides management support and acts as a partner and advisor to the entrepreneur. Thus he is different form a banker and a investor of the shares of an enterprise. Venture capital is available as early stage financing, expansion financing and acquisition financing.

8.5 Keywords used in the lesson

- ✓ Venture Capital
- ✓ Conventional financing

8.6 Further reading

Indian Financial System: Markets. Institutions and Services, 2/e Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets. Institutions and Services, 3/e, by

Bharati V. Pathak

8.7 Answer to check your progress question

1. High technology and risky projects.
2. Commercial and technological
3. 1986-87
4. 1987

8.8 Model Questions

1. What do you mean by venture capital? How it differs form conventional financing?

2. Briefly mention the venture capital scenario in India?

3. What are the major details required to be submitted by a potential investee company for raising venture capital?

UNIT – 9

9.1 CONSUMER CREDIT

9.1 Introduction
9.2 Unit Objective
9.3 Unit structure
9.3.1 Meaning and Definitions of Consumer Credit
9.3.2 Features of Consumer Credit Transaction
9.3.3 Legal Framework
9.4 MUTUAL FUNDS
9.4.1 Meaning and Definition of Mutual Funds
9.4.2 Raising finance through Mutual funds
9.4.3 Performance of Mutual Funds – a critical analysis
9.5 CERTIFICATES OF DEPOSIT
9.5.1 Concept and Features of Certificates of Deposit
9.5.2 Operations of Certificate of Deposits
9.6 COMMERCIAL PAPER
9.6.1 Concept and Features of Commercial Paper
9.6.2 Operation of CP
9.7 Summary
9.8 Answer to check your progress question
9.9 Model Questions

9.1 Introduction

'Consumer Credit' encompasses all asset-based financing plans that are offered primarily to individuals for acquiring consumer durables. The typical form of consumer credit transaction is one where the individual pays a fraction of the cash purchase price on talking delivery of the asset and agrees to pay the balance with interest over a specified period of time.

9.2 Unit Objectives

- To understand the concepts of consumer credit
- To identify transaction of consumer credit
- To know the operations of mutual funds in India
- To analyse the operation of Commercial paper and Certificate of Deposit

9.3.1 Meaning and Definitions of Consumer Credit:

In India the practice of offering consumer credit has been in vogue for a very long period of time but it remained fragmented and individualized until the late eighties. The credit for educating the 500 million strong Indian middle class about the advantages of the 'BUY NOW: pay later' culture must go to Citibank. which went in for an aggressive marketing of consumer finance through a

wide array of schemes the City Mobile Finance Scheme for financing purchase of new cars the 'Wheels' scheme for financing purchase of two wheelers and the 'Easy Buys' scheme for financing purchase of consumer durables like VCRs, VCPs, TVs. refrigerators, washing machines and home appliances.

Following the lead taken by citi bank, the other multi-national banks, the State Bank of India and a number of finance companies which were on the look-out for concentric diversification opportunities jumped into the Fray. Of course the factors which motivated these financial intermediaries to enter the consumer credit industry were the growing strength of the upwardly mobile Indian middle class, the rapid increase in the disposable income of this class and the boom in the consumer durables and automobile industries during the latter half of the eighties.

9.3.2 Features of Consumer Credit Transaction :

The salient features of consumer transactions are as follows:

(i) Number of parties to the Transaction :

The transaction can be either a bipartite one involving the dealer-cum-financier and the borrower / customer or a tripartite one where the dealer and the financer are who distinct entities.

The tripartite transaction can be of the sale-aid type where the dealer arranges for finance and does the necessary paper work on behalf of the borrower. Under such transactions the credit granting decision lays with the dealer, of course subect to the eligibility criteria stipulated by the finance company. Such transactions are structured with recourse to the dealer. On the other hand a tripartite transaction can be of the conventional type where the customer approaches the finance company to avail of the credit facility.

(ii) Strucutre of the Transaction:

A consumer credit transaction can be structured in the form of the hire purchase, conditional state or credit sale transaction. A hire purchase is a contract of hire with the option to purchase. The customer, while having the option to purchase need not do sound can terminate the agreement and return the goods at any time subject to the terms and conditions of the agreement. In a conditional sale contract, the ownership is not transferred to the customer until the total purchase price (including the charge for credit) is paid and the customer cannot terminate the agreement before the purchase price is paid. Most of the tripartite consumer finance transactions are of the hire purchase type.

Check Your Progress

1. The __________ transaction where the dealer arranges for finance and does the necessary paper work on behalf of the borrower.

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(iii) Down Payment:

Consumer Finance Schemes can be broadly classified under two categories: Down Payment Scheme and Deposit Linked Schemes. Since we have already drawn the distinction between the two types of schemes we are not going over the same ground here. The Down Payment varies between 20% and 25% of the value of the consumer durable. Likewise the security deposit under the Deposit Linked Scheme varies between 15-25 percent of the amount financed (which is equal to the investment outlay). The deposit is of cumulative nature carrying interest at a prescribed rate (which at the time of writing cannot exceed 15% compounded monthly). Some finance companies also offer Zero Deposit Scheme under which the Equated Installment (EMI) is higher than EMI under the 15% and 25% deposit schemes.

(iv) Repayment Period and Rate of Interest:

The repayment schedule is drawn on the basis of monthly installments over a period varying between 12 months and 60 months. The borrowers are permitted to choose the most convenient payment period from the given range of option. While the rate of interest is typically expressed as a flat rate some financial intermediaries like City Bank disclose the effective rate of interest. In recent times many finance companies have dispensed with the practice of disclosing the rate of interest. Instead they disclose the equated monthly installments associated with the different repayment periods and require the borrower to figure out the effective rate of interest for himself.

The repayment is required to be made through post-dated cheques. In respect of institutional consumer credit schemes where the finance is routed through the organization which employs the borrower, organization concerned is required to deduct EMI at source and transmit the payments to the finance company. Most of the schemes for early repayment of the loan subject to certain conditions. They also provide for either a rebate from prompt payment (prompt payment bonus) or for a delayed payment charge.

(v) Security:

The consumer credit is secured through a first charge on the asset concerned and the borrower is prohibited from selling or pledging or hypothecating the asset during the credit period.

Check Your Progress

2. The ________ is secured through a first charge on the asset concerned and the borrower is prohibited from selling or pledging or hypothecating the asset during the credit period.

(vi) Product Range:

Consumer credit is made available for a wide range of durables like passenger cars, two wheelers, TVs, VCRs personal computers, washing machines, cooking ranges, food processors and mini-generators.

(vii) Borrower Profile and Eligibility Criteria:

The types of borrowers covered by the consumer finance scheme are the individual, partnership firms, private and public limited companies.

The eligibility criteria for individual borrowers include a minimum level of annual emoluments minimum, number of years in the present employment and minimum take home salary. For partnership firms and companies the criteria include a profitable track record minimum level of sales and net worth.

An illustrative set of eligibility criteria for the different types of borrowers are presented in Table 9.1.

Table 9.1
Elgibility Criteria for Borrowers

Type of borrower	Criteria
Individual	• Minimum gross annual income of Rs.10,00,000 • Atleast two years of continuous employment with the present employer. • Atleast five years of employment till retirement. • At most two changes in employment in the last five years. • A net take home monthly salary which is three times the EMI (Equated Monthly Instalment).
Partnership Firms and Companies.	• Must have been is existence for a minimum period of four years and making profits for atleast two of the last three years

NOTES

	• Net profit plus depreciation must be atleast 3 times the annual instalment. • Must have a minimum net worth of Rs.2.5 lakhs

9.3.3 Legal Framework:

In countries like the U.S.A. and the U.K. where consumer credit has been in popular use for long, it is subject to comprehensive frameworks. The legislation seeks to (a) make the customer more aware of the true interest rates implicit in the various lending schemes and (b) protect him against the unscrupulous once the agreement is made. To have a better understanding of the scope of such legislation, we will touch upon the salient features of the consumer credit Act 1947 of the U.K.

1. The Act applies to contracts for the provision of credit (Whether on loan, hire purchase, credit sale or any other basis) where the customer or borrower is anyone except a body corporate and the amount of credit (excluding charges or any deposit) is $ 1,50,000 or less.

2. The Act requires every intermediary which provides consumer credit or acts as a credit reference agency, debt collector broker to obtain a license from the Office of Fair Trading (OFT) to carry on business.

3. The Act defines the types of ancillary charges to be included for the purpose of determining the total charge for credit. For example, the compulsory asset maintenance charges to be paid by the borrower during the credit period or the option charge for early repayment are to be included in the computation of the total charge for credit.

4. The Act regulates the information to be disclosed in the credit advertisements. It also restricts Canvassing off trade premises like door-to-door selling of credit facilities.

5. The Act requires the Annual Percentage Rate (APR) of the total charge for credit to be calculated on the basis of Compound Interest Principles. The APR is to be quoted to the lower on tenth of one percent. For example if the APR works out to 20.76% it must be quoted as 20.7%. The APR must be disclosed in all credit advertisements and quotations.

Check Your Progress
3. The required Minimum gross annual income to avail consumer credit for an individual is __________.

6. The Regulations accompanying the Act specify in considerable detail the information to be contained in the credit agreements. A credit agreement that is not drawn in accordance with these requirements is not enforceable against the borrower.

7. The Act allows the borrower to pause and reflect over his decision after signing the agreement under some circumstances. For example if the borrower has signed the agreement at a place away from the trade premises, he can reflect over his decision and reverse it by cancelling the agreement within a specified period of time. Likewise the Act provides for a (pause for reflection) in respect of credit agreements secured on land.

8. The Act has been designed to the advantage of the borrower in the sense that it restricts the lender's rights to repossess the goods in the event of default or to charge penal charge on overdue payment. For example the Act states that where the borrower has committed an act of breach, the lender cannot repossess the goods concerned without obtaining a court order or the express permission of the borrower provided one third of the contractual price has been paid. Likewise the Act states that the interest charged on overdue payments cannot exceed the APR of the transaction.

9. The Act permits the borrower to opt for early repayment and the regulations accompanying the Act provide for the method to be used in calculating the interest rebate. These regulations permit the lender to use the Modified Rule of 78 methods but specify the maximum deferment period that can be built into this method interest rebate under the Modified Rule of 78 is given by the formula.

$$R = \frac{(t - \alpha)(t - \alpha + 1)}{n(n + 1)} * D$$

Where α is the deferment period. The Act specifies that exceed 1 for loans with an original term to maturity of more than 5 years and cannot exceed 2 for loans with an original term to maturity of five years or less.

10. The Act enables the borrower to access any credit information concerning him that may be maintained by a Credit Reference Agency and correct such information that is materially incorrect.

As we said earlier there is an urgent need for comprehensive consumer credit legislation in the Indian context. As of date the only legislative provision touching upon the pricing of credits Sec.36A (1) of the MRTP Act, 1969. According to this section a trade practice which materially misleads the public concerning the price at which a product or like products or goods or services have been or are ordinarily sold or provided would be an unfair trade practice. This clause thus classifies any mis-representation about the rate of interest in a credit advertisement or quotation as an unfair trade practice.

9.3.4 Consumer Credit Portfolio Management : Some Aspects :

A is often said, building a large consumer credit portfolio is not a difficult task as compared to managing one. This is so because managing entails evaluating, monitoring and controlling a large number of individual accounts. Therefore a consumer credit institution must primarily focus on stream-lining the credit management function.

(i) **Credit Evaluation:**

The first step in the streamline process is to define and articulate a clear cut procedure for evaluating customers. This is an onerous and difficult task. It is onerous because the number of customers to be credit rate is quite large. It is difficult because there are no hard data on the past payment record or on the financial position of the borrower (like the audited financial statements) to judge the willingness and the ability to repay.

In some countries credit reference bureaus do provide a large part of information require for evaluating the credit applicant.

The typical data stored on the individual file include:

- Record of all registered country court judgments and decrees in the last six years.
- Information supplied by other traders with regard to bad debts, slow paying accounts and repossessions.
- Records of bankruptcies and administration orders.
- Voters roll information.

Check Your Progress
4. _______ provides a information about the consumer for evaluating the credit applicant.

Some credit bureaus also file details of all satisfactory credit transactions reported to them by other users. In the Indian context, there are no credit bureaus to aid the credit granting decision. For the credit evaluation of an individual borrower, the finance company calls for a copy of the salary certificate and the name and address of the

employer. For the credit evaluation of business entities like sole proprietorship and partnership the finance company looks for the financial statements for the last two years duly certified by a chartered accountant and the addresses of the bankers with whom the business entity has credit facility. Thus checking with the employer and the banker seem to be the only ways of obtaining independent reference information in India.

(ii) **Methods of Pre-screening Borrowers:**

Since a finance company engaged in offering consumer credit has to assess the credit-worthiness of a large number of individual borrowers, it makes a lot of sense to use a mechanical scoring system for a preliminary evaluation of the credit applicants. An illustrative questionnaire which can be used for this purpose is provided in table 1. The reader can find a number within parentheses appended to each questions. This indicates the percentage of borrowers in that category who subsequently defaulted.

A perusal of the questionnaire reveals that what we are trying to obtain is an overall risk index for the loan applicant. The way to to it is add-up the relevant probabilities of default in the categories. In our example the borrower who gave the most unfavorable response to each question will have a risk index of 28 and the (smart) borrower who furnished all favorable responses will have a risk index of 3. To discriminate between the good and the bad risks, the finance company will have to define its own acceptable risk index. For instance it may decide all loan applications with a credit risk index more than 10 will be rejected.

Table 9.2
Questionnaire for Evaluation of Loan Applicants with Default Rates

1. Do you have a telephone at residence	
Yes	(0.7)
No	(1.0)
2. Do you :	
Own your Home	(0.7)
Rent a House	(2.4)
Rent a Room	(6.5)
3. How long have you spent in your present job	
Less than 6 months	(8.4)

7 to 24 months	(3.2)
More than 24 months	(0.2)
4. What is your take home monthly pay	
Less than Rs.2500	(8.8)
Between Rs.2500 to Rs.4500	(3.3)
Above Rs.4500	(0.4)
5. How many are there in your family	
One or Two	(0.2)
Three or Five	(0.7)
More than Five	(2.0)
6. For how long do you require the loan	
12 months or less	(1.3)
More than 12 months	(0.8)

The reader must have observed that the method we have employed for separating the sheep from the goats is conceptually weak because adding up the probabilities the way we did ignores the interactions between the different factors. As an alternative we can use the information provided by the questionnaire to identify the factors relevant for credit rating and combine them using the statistical technique of Multiple Discriminate Analysis. Suppose we are considering only two such factors we can also use the graphical approach. For example if we regard the take home pay and the number of months spent on the present job as two relevant factors then we can define the credit index as follows :

$$Z = aX1 + bX2$$

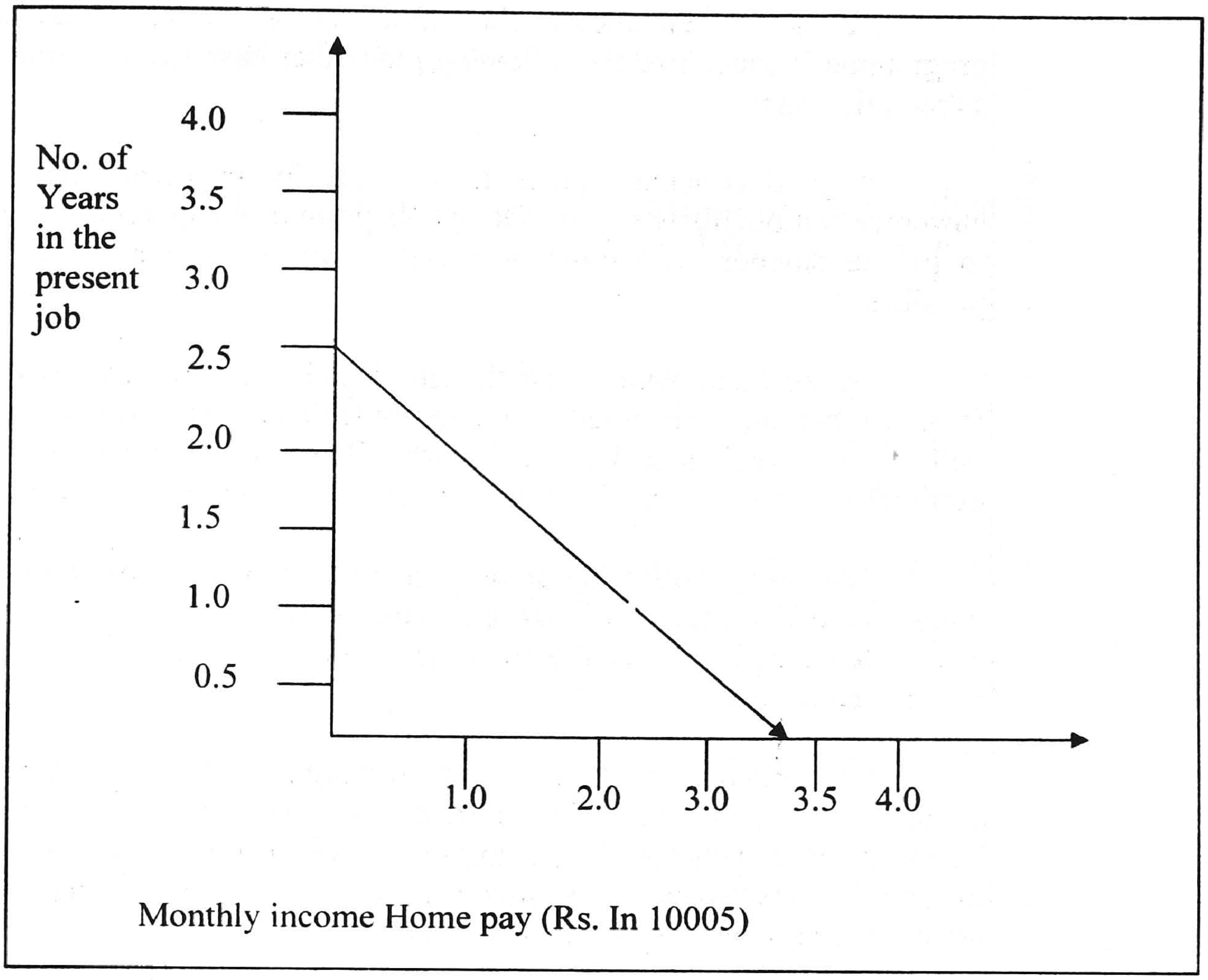
Z = index of credit worthiness

Where x1 = take-home monthly income (in rupees)

X2 = number of years spent on the present job

Based on a sample drawn the past data (considering of both defaulters and non-defaulters) we can draw a scatter diagram as shown in figure 1.

Figure 9.1 scatter diagram



In this diagram O's represent the customers who have defaulted and X's denotes the customers who have paid on time. A visual inspection of the scatter of points reveals that we can draw a discriminating line intercepting the X1 axis at 3.2 and X2 axis at 2.4 such that the two groups – the defaulters and non defaulters are kept as far as possible. The equation is therefore,

$$Z = 3X1 + 4X2$$

Or index = 3 (Take – Home monthly pay in 000's rupees) + 4 (No. of months on the current job expressed as fraction of year)

Credit applicants with an index of 9.6 or more will be accepted and applicants with an index of less than 9.6 will be rejected.

(iii) Book-keeping and Collection:

Managing consumer credit portfolio effectively requires (a) a system of book-keeping that is accurate; and (b) a collection programme that is consistent and persistent. Collection efforts are bound to deteriorate if the slow-paying accounts cannot be followed up with authority because information is not up to date.

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As far as enhancing the effectiveness of the collection programme is concerned the following guidelines have been offered by a credit manager.

A good collection practice is to ask for payment when the customer is most likely to pay. The whole point of a collection letter is to induce payment and must be timed to arrive as near to pay as possible.

For accounts which miss the first installment the first payment failure, a personal call must be made immediately. The personal call will at least confirm that the customer still lives at the address and establish the real reason why the account has not been paid properly.

The person following up an account should not threaten action unless his office intends to take the action if the account is not paid. The customer will not take the credit department seriously if it does not mean what it says.

Slow paying accounts with small balances do not justify legal action on economic grounds. In such cases, the collection of such balances can be achieved by getting the customer to sign a declaration to pay by say weekly installments. Of course the last resort is recovering large accounts is legal action.

9.4 Mutual Funds :

9.4.1 Meaning and Definition of Mutual Funds :

A mutual fund is a fund in which investors pool their funds to invest in a diversified portfolio so as to spread and minimize the risk. It is a collective investment device by which expert investment advice is provided and profits are equally (on the basis of share holding) shared among it's participate. Mutual fund companies employ their investors the combined benefits of low risk, steady return, high liquidity and capital appreciation.

Check Your Progress
5. A ________ is a fund in which investors pool their funds to invest in a diversified portfolio so as to spread and minimize the risk.

From operational point of view, mutual funds are of two types open ended and close ended. If the period and / or target amount of the fund is define, the find is called close ended, otherwise it is indefinite it is called opened ended. Depending on investment needs of different kinds of investors, various types of mutual funds like income oriented fund, Growth oriented fund, Hybrid fund, high growth fund etc., are in vogue.

The securities of Exchange Board of India (Mutual Funds) Regulations, 1993 defines as, "a fund established in the form of a trust by a sponsor, to raise monies by the trustees through the sale of units to

the public under one or more schemes. for investing in securities in accordance with these regulations".

Mutual Funds Operations in India:

In India the concept of mutual fund emerged with the inception of Unit Trust of India 1964 and the launching of the first open ended scheme " Unit Scheme 1964 ".

The present day mutual funds are close ended mutual funds which provide fixed incomes at regular intervals as well as capital appreciation at the end of the scheme. The first close ended mutual fund scheme 'Mastershare' was also floated by the UTI in 1986. Later on a number of commercial banks – State Bank of India and Canara Bank (1987-88), Indian Bank, Bank of India and Punjab National Bank (1988-89) and other investments institutions – (LIC) (1989-90) and GIC (1990-91) set up mutual funds and launched a variety of schemes to providing a wider choice to small investors.

With a view to attracting foreign capital, especially from NRI's a few schemes, viz India Fund Unit (1988) by UTI, cancigo and cangit (1987) by a canara bank and Fidelity International (1991) by RBI have been set up. A number of mutual funds in the private sector are likely to enter the capital market in the near future.

During 1989-90, total funds mobilized by some of the important mutual funds were UTI, Rs.5583 crores. SBIMF Rs.243 crores, Canbank Mutual Funds Rs.382 crores and Indian Bank MF Rs.124 crores. The total investible funds of all mutual funds were around Rs.18000 crores out of which those of UT accounted for Rs.15,892 crores.

The investment pattern of mutual funds has revealed that bulk (more than 50%) of their investment has gone in favour of fixed interest securities in comparison to equities (approx 25%). Some of the mutual funds also invested in money market instrument its short term call money, etc.

Money market Mutual Funds (MMMF). a new version of mutual funds have been cleared by RBI mainly short term avenues to investors. This will enable individuals and small bodies to avail of the facility of money market instruments. The minimum sizw of investment would be Rs.1 lakh and repurchases should be subject to minimum lock in period of 3 months.

9.5.1 Raising finance through Mutual funds :

Check Your Progress
6. Unit Trust of India launched the first open ended scheme, which is called as ________.

The establishment of Mutual Funds in India augurs well for good companies seeking financial resources. Mutual Funds serve as distributors of small savings towards industry, and offer safety, returns

and liquidity to unit holders. It will be worthwhile to take note of the number of mutual funds operating in India, study their objectives and gauge their investment styles.

Currently 20% of the public issue offerings can be placed with Mutual Funds, on Firm Allotment Basis, as per the prevailing SEBI guidelines. This factor assumes significance on three courts. Second and more important it enhances the credibility of the issue and its promoters. Third, it provides the investee company an opportunity to establish a long term relationship with a truly professional investor.

A classification of mutual funds promoter wise is provided in the table along with (see table) alongside.

Considering the investment styles, the following method of classification emerges: (1) Growth & capital Appreciation, (2) Fixed Income.

Primarily Issues can be taken up by growth schemes, whereas Debentures can be taken up by Fixed Income Scheme. Acquisition of blue-chip stocks at opportune times will provide scope for both capital appreciation as well as a favorable Dividend Yield, thus marking it suitable for both types of schemes.

Indian Markets are inefficient, with outdated trading and delivery systems and with technical analysis rendered useless due to insider trading and other malpractices. Under the circumstances primarily issues are a safer bet, as far as equity investments are concerned. However thus far we do not have any mutual fund specializing in emerging industries/companies. Initiative towards this end has been taken by UTI which has placed funds with TDICI, India's premier Venture Capital Company.

The concept of sartorial mutual funds is well understood but yet to take off. Here again the mutual funds are severally restricted by the current SEBI guidelines. A fund cannot acquire more than 5% of a company and 15% of an industry. These rules seem outdated from two points of view. One. even sections 370 and 372 with all their restrictions, allow a corporate are better placed to take positions in brought out deals and investments as compared to mutual funds. Two modern portfolio techniques such as 'Harry Markowitz' Diversification theory along with the use of computer simulated risk return moldering, make thumb rule "basket ceilings" seem crude and counterproductive. Instead of regulated ceilings, better disclosure standards will be helpful.

In times to come, mutual funds will have wider choices of investment. The common investor is unable to comprehend the technicalities of debt instruments and financial derivatives. Structured debt instruments may suit the requirements of corporate but some

issues are marketable only to mutual funds, being capable of sophisticated analysis. The table 9.3 gives the details of list of mutual funds.

Table 9.3
List of mututal funds

PUBLIC SECTOR	FINANCE COMPANIES	INDUSTRIAL GROUPS	FOREIGN ORIGIN
Unit Trust of India	20th century	Birla	Alliance
LIC Mutual Fund	Apple	Escorts	Jardine Eleming
GIC Mutual Fund	CRB	Kothari pioneer	Morgan Stanley
BANKS/His	Credit capital	Shriram	Merill Lynch
BOI	First leasing	Reliance	
BOB	Kotak	Tata	
Canbank	JM Financial		
Indbank			
PNB			
SBI			
ICICI			
IDBI			

9.4.3 Performance of Mutual Funds – a critical analysis :

There is a crisis of confidence in the mutual fund industry. Through it is tempting to blame it on the state of the market that would not even be half the story. There has to be much more to explain the fact even now thirty plus years after UTI was founded, eight years after the other funds came in and two years into private sector funds, the debate on whether mutual funds are such a great idea after all goes on?

But then the investors too should take a part of the blame. They bought the product without knowing why.

Indeed the situation is such that new schemes find few takers. All of this may sound like an epitaph for the industry but it is actually a sign of the maturing of the industry. The sign of that will be the definite shift from the plain vanilla products of today to more intelligently constructed products. The shift will be slow and there may well be a weeding out, but it is sure to come.

How did the situation come to such a pass? It would seem that perhaps the seeds were sown when UTI's Master gain was greeted with a thunderous response with investors parting with over Rs.46000 million of their saving offering it to UTI to manage.

UTI was overwhelmed. The existing investor servicing machinery performed sub optimally and UTI's funds management team did not come out with flying colors either. Thousands of investors watched helplessly even as UTI struggled to cope with the situation.

None of this considered the enthusiasm of the winnable of the funds management business. Every major financial sector intermediary announced plans to float a mutual fund. Enter Morgan Stanely. Here was a foreign company about which one read only in the papers; a company with very strong brand equity. Investors tripped over each other to apply for Morgan's Stanely offering.

The marketing strategy seemed flawless and an impression was created that only the earliest birds would get a piece of the action. Small wonder then that an active grey market emerged and that's when disaster struck, the public was outraged the authorities seemed to take umbrage and the company quickly took corrective action. But the damage had been done and a negative image stuck.

If the fund got off to a jump start perhaps all would have been forgiven and forgotten. But the fund has been quoted well below its issue price for such a long time now, that people who had subscribed to Morgan Stanely at Rs.10 are not prepared to believe that it may actually pay off on a later date.

Those that had punted on the grey market were seeing red. The investing public realized that if one wished to invest in a close ended fund, one was better off picking it up in the secondary market after listing. Suddenly many companies shelved their plans yet others scaled their plans down.

Then came to the final straw, UTI got itself into trouble by picking up large lots of Reliance shares at high prices if the market came tumbling down shortly thereafter.

UTI did not look so good. If the number one fund manager in the country can make such mistakes, who can the small guy turn to asked others? Nobody had any answers.

The fact that mere events happened close on the heels of each other served to have a negative impact on the investors psyche a domino effect is the best way to describe it.

But the irony of it all us that should happen so close on the heels of a shift in investor's asset preference in favour of mutual funds. A survey had found that whereas equity was the most favoured for investors in 1991\92. it was UTI in the following year.

This was interpreted by many as being suggestive of a mutual fund culture taking root faster than was previously acknowledged. Many believed genuinely that the day of the mutual fund had arrived. Little did they know then that a concentration of events would push that day further away?

These four issues have affected the market more fundamentally than many people care to acknowledge. It seemed to affect the fortunes of all mutual funds so many funds so much and so adversely that none of the fund managers wanted to get into the business longer.

But the market did acknowledge good track records as the success of Kothari indicated.

This phase of disillusionment provides an opportunity for introspection at the end of which we should have answers to some basic questions. If and when that happens, the market would have matured. But will it mean that investing in mutual funds will be a good idea? No, not necessarily for all classes of investors and not necessarily for all times. But they will certainly find a place in the overall asset allocation of all classes of investors. It is useful to explore how that will happen and to what extent.

To begin do mutual funds make sense because of the limitation that investors face and to some extent the convenience the mutual funds offer.

There is a cost to information. A household investor cannot possibly expect to consistently forecast future corporate performance as well as a fund supported by a good research team

There is also the matter of lumpiness of investment. The proportional system of allotment in new issues or the rule stipulating that minimum application would have to be for 500 shares makes it difficult for people with lower investible funds to get in.

The only way out then would be through some form of pooling. An investment club serves this purpose eminently as does a mutual fund. The difference is that while in the former an investor may have a

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say in the choice of the investment avenue, it is seldom the case in the latter.

When will the retail investor flock to the mutual fund them? When will the potential turn into reality? At the macro level, in a matured, sophisticated capital market which entails risk related returns, increasingly stricter insider trading norms and resultant need to have support of quality research to make money consistently in the long run, will induce the small investors to mutual funds.

Free issue pricing and proportionate allotment system has already eliminated to a large extent, the almost risk free lottery available to individual investors. The explosive growth in the listed stocks (India is second behind the USA in terms of listed companies) has made scanning and spotting of opportunity increasingly difficult for individual investor with obvious constraints on availability of resources and access to the information.

This applies equally to smaller corporate and institutional funds who may not have adequate where with all to manage own money in fact. The next phase of growth of mutual funds in India will probably come with the relaxation of PF trust investment rules allowing these trusts to invest in mutual funds units. That would possibly come when fixed income funds gain currency. And it promises to be a dramatic event.

9.5 CERTIFICATES OF DEPOSIT

9.5.1 Concept and Features of Certificates of Deposit :

The Indian money market continued to witness significant changes to instrument development deregulation and gradual easing of controls. The most significant development was the removal of interest rate ceilings on all money market instruments with effect from May 1, 1989. new money market instruments such as certificates of Deposit (CD) and Commercial Paper (CP) were introduced to give greater flexibility to investors in the deployment of their short term surplus funds in CDs and Cps and to enable highly rated corporate borrowers to diversify their sources of short term borrowings and raise a part of their resource requirements at market rates by issuing CPs.

CD is a negotiable instrument issued at a discount and the face value is payable on maturity. The recent examples are deep discount bonds of IDBI and happy return bonds of SIDBI. CD's are short term deposit instruments with maturity period ranging from 3 months to 365 days. The minimum amount of CD is Rs.25 lakhs and it is subject to stamp duty. CD is transferable by endorsement and delivery after 45 days of issue. It fills in the gap between bills and dated securities. The

Check Your Progress
7. Certificate of Deposit (CD) and Commercial Paper (CP) were introduced in the year ______.

maturity period of CD in the market can range from 1 to 320 days. The discount of CD is determined by market. CD is an ideal instrument where surplus funds are to be parked for three months to one year.

The important difference between a Fixed Deposit Receipt (FDR) and a CD is that the latter is negotiable while the former is not. An FDR is redeemable only with the bank and only when the deposit matures. A CD on the other hand is saleable to a third party, and is hence highly liquid. The banker is required to redeem the CD only on its maturity.

However, liquidity and marketability of CDs requires the existence of an active secondary market. In the absence of a secondary market in India, Certificates of Deposit were not introduced earlier. The Tamble Committee had opined that introduction of certificate of deposits was not advisable in a money market where interest rates are administered. The Vaghual Committee which looked into the development of money market instrument recommended that interest rates on short term deposits should be properly aligned with other rates in the monetary system, before CDs are introduced. Interest on short term deposits (15 days to 45 days) was very low, making it unattractive for institutions to keep their short term funds. The call money market which provides an alternative venue of parking short term funds is not open to institutions other than banks, UTI and LIC. In this context a need arises to make available a short term instrument that can augment resources of financial institutions and business entities. Before introducing CDs as a short term money market instrument, it provides a higher rate of interest available on short term deposits.

9.5.2 Operations of Certificate of Deposits :

In terms of the guidelines of the Reserve Bank of India of issues of CDs, banks can issue CDs at a discount to face value determined freely with a maturity ranging from 3 months to 1 year and the minimum size of issue to a single depositor of Rs.1 crore. The denomination of CDs was reduced to be in multiples of Rs.10 lakhs (instead of Rs.25 lakhs) and the minimum size of an issue to a single depositor to be Rs.50 lakhs (instead of 100 lakhs). Originally, a bank's outstanding aggregate deposits during the financial year 1988-89, the limit was earlier increased in fortnightly average outstanding aggregate associations, etc. NRIs can also subscribe to CDs but only on a non-repatriation basis. Banks are required to maintain the useful reserves (CRR and SLR) on the issue price of CDs and report them as deposits to Reserve Bank of India. CDs are to be issued in the form of usance promissory not payable on a fixed date without any grace period and are therefore freely transferable by endorsement and delivery but only after 45 days of the date of issues. CD will be subject to stamp duty as applicable. The scheme of CDs has shown encouraging growth and against a total permissible limit for issue by the banking system of Rs.1264 crores, the amount of CDs issued as on limit as on March 23,

Check Your Progress

8. The instrument which can be sold to a third party is called as ______.

NOTES

1990 was of the order of Rs.1103 crores equivalent to 87.3 percent of the permissible limit.

Effetctive May 2, 1992 the limits for issue of Certificates of Deposits (CDs) by scheduled commercial banks (excluding regional rural banks) were enhanced from 5 percent to 7 percent of the fortnightly average outstanding deposits in 1989-90. Consequently, the aggregate limits for the banking system for issue of CDs increased from Rs.7537 crore to Rs.10531 crore. CDs issued by banks in excess of the earlier limit of 5 percent will not be subject to the CRR.

Three financial institutions viz, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India and Industrial Finance Corporation of India were permitted to issue CDs with a maturity period of more than one year and up to three years with an initial aggregate limit of Rs.1000 crore.

The outstanding amount of CDs issued by these institutions was Rs.538.54 crore as on June 26, 1992. Considering the resources constraints and also the need to provide flexibility to financial institutions to raise resources the limits for issue of CDs of these three institutions were further enhanced to Rs.1350 crore in May 1992. The Industrial Reconstruction Bank of India has also been permitted to issue CDs up to a limit of Rs.100 crore with effective from July 29, 1992. The outstanding amount of CDs issued by these institutions as on August 21, 1992 was rs.717.27 crore.

The volume of CDs issued by the scheduled commercial banks rose from Rs.5682 crore on 20-3-1992 to Rs.8469 crore on October 20, 1992. Banks pay a higher interest rate on CDs. Hence holders of CDs prefer to hold them till maturity. An effective secondary market has not developed so far in CDs.

9.6 COMMERCIAL PAPER

9.6.1 Concept and Features of Commercial Paper :

Commercial paper, the new instrument for the Indian Financial Market by which companies can rise short term and medium term debt at attractive rates is likely to make a dent in the near future.

A commercial paper (CP) is a short-term money market instrument consisting of unsecured promissory notes with a fixed maturity usually between seven days and three months, issued in bearer form and on a discount basis. Issues may be made on an interval basis, or more generally, under a revolving underwriting facility extended by banks tailored to the needs of cash flow requirements of the issuer. It is either sold directly by the issuer to the investors or placed by an intermediary bank or securities dealer.

Check Your Progress
9. CD can be issued for a maximum amount of ______.

The advantages of a CP spring from simplicity including simple documentation and flexibility both in respect of maturities and amounts tailored to the requirements of the issuer. The issuer gets access to diversified sources of short-term funds at more competitive rests. The investor also stands to benefit in that a CP offers a higher yielding alternative to call money deposits or treasury bills. The development of a CP market therefore, depends on the nature of the existing national financial market and banking system, or in other words the availability of alternative forms of short-term borrowing and their relative costs. In centers where there are compulsory reserve requirements on bank intermediaries. CP issues will tend to be cheaper than and therefore substitute short-term bank borrowing. Where there are no compulsory reserve requirements the scope for a CP is correspondingly more limited. Never the less irrespective of the cost structure of the short-term funds in the national market, the CP market enlarges the spectrum of available forms of borrowing and provides a cheap and flexible alternative to the more expensive forms of bank finance.

9.6.2 Operation of CP :

CP's are unsecured promissory noted by highly rated companies with a tangible net worth of Rs.5 crores or more having a maturity period of 3 months to 6 months at a discounted value determined by market forces. The minimum issue size is Rs.25 lakhs and then in multiples of Rs.5 lakhs. The fund based working capital limit of the issuing company should be Rs.10 crores or more and the company can issue CP upto 30 percent of its working capital credit limits. CP is subject to credit rating by any of the credit rating agencies in India. CP's are traded in secondary market and are thus liquid. But there is no active trading of CP in secondary market although direct sellers of CP repurchase the CP on request. The trend in the primary market is encouraging.

CP was introduced in India in January, 1990.

RBI has issued guidelines for issuance of CP's in 1989 which have further been simplified. These are as under:

(ii) CP would be issued in the form of promissory notes at a discount of face value and the rate would be freely determined.

(iii) CP would be issued for a minimum maturity of 3 months and maximum maturity period of 6 months from the date of issue.

(iv) The denomination of CP could be multiples of Rs.5 lakhs subject to the minimum size of an issue to a single investor being not less than Rs.25 lakhs (face value).

Check Your Progress

10. CP was introduced in India in the year ———.

(v) The issuing company have a tangible net worth of not than Rs.5 crore as per the latest balance sheet a fund based working capital limit of not less than Rs.5 crore credit rating of P2/A2 or higher from the CRISIL/CRA of not less than two months old and a minimum debt equity ratio of 1:33:1

(vi) The issuing company should be listed on one of the stock exchanges in India. This stipulation would not apply to public sector companies and closely held companies.

(vii) Banks would not be permitted to either under write or co-accept issue of CPs. Banks may however provide stand-by facility to issuing company to the extent of the issue.

(viii) The maximum amount of CPs that can be issued by a company will be limited to 75 percent of the maximum permissible bank finance. Once the issue is actually placed, the issuing company's banks would be required to suitably adjust the maximum permissible bank finance.

(ix) CP can be issued to any person or corporate bodies' registered or incorporated in India (including banks) as well as un-incorporated bodies. Non-resident Indians can, however invest in CPs only on non-repatriation basis and such CPs cannot be transferred.

(x) Issue of CP will be subject of stamp duty.

Issue of CP is exempt from provision of section 58A of companies Act 1956, relating to deposits. Issue of CP involves lesser paper work. It provides flexibility to the company by giving an additional option of raising funds particularly when the conditions prevailing in the money market are favorable.

From 1990 to March. 1993 CP's issued in our country aggregated to Rs.2700 crore. During 1992-93 there were 125 issues of CP's by 44 companies aggregating to Rs.1438 crore. The discount rate varied from 15 to 21 percent. About 80 percent of these issues were for a maturity period of 3 months. The introduction of CP has certainly given flexibility to well rated corporate borrowers in short term fund management and has thus helped in lowering cost of funds. In view of its free negotiability CP has an edge over other money market instruments.

The use of CP is much more in developed countries like US, Japan and other European countries.

9.7 Summary :

The term consumer credit encompasses all types of asset financing plans offered primarily for acquiring consumer durables. The consumer loans usually carry a flat rate of interest that varies between 13% - 15% and a repayment period that various between 12 and 60 months. The repayment is required to be made by issuing post-dated cheques at the time of availing of the loan. The loan is secured by a first charge on the asset concerned and is also guaranteed by a guarantor. A CD is a document of title of a time deposit but distinguished from conventional time deposit in respect of its free negotiability. CD can be issued for a maximum amount of Rs.25 lakhs and then after multiples of 5 lakhs. A CD can be issued from 3 months to maximum period of one year. They are transferable by endorsement and delivery after 45 days of date of issue. Commercial papers are unsecured promissory notes by corporate entities to raise working capital requirements directly from the markets, instead of from the companies' bankers for short period. By issue of CPs there will be no net increase in their borrowings.

9.8 Keywords used in the lesson

- ✓ Mutual funds
- ✓ Certificate of Deposit
- ✓ Commercial paper

9.9 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e
Pearson Book
Indian Stock Market by Bishnupriya Mishra
The Indian Financial System: Markets, Institutions and Services, 3/e, by
Bharati V. Pathak

9.10 Answer to check your progress question

1. Tripartite
2. Consumer Credit
3. 10, 00,000
4. Credit reference
5. Mutual fund
6. Unit Scheme, 1964
7.1989
8. Commercial Deposit
9. 25, 00,000
10. 1990

9.11 Model Questions

1. What is commercial paper? As a new instrument is it a useful tool to the business companies?

2. What is meant by Consumer Credit? Explain the various features of Consumer Credit?

3. Is mutual fund a useful tool for raising finance?

4. Classify the Mutual Funds promoters into major groups.

5. Is there a crisis of confidence in the Mutual Fund industry persently?

6. What is a certificate of Deposit? Is it functioning as an important source of mobilising deposit for commercial banks?

Problems

1. A consumer loan of Rs.20000 is repayable in 60 monthly instalments (in arrear) of Rs.560. calculate the APR of the transaction.

2. A television set which costs Rs.8000 can be purchased by 52 weekly instalments of Rs.160 payable in arrear. What is the APR on this transaction?

3. Under the Finance Plan of Universal Finance Company (UFC) a self-employed professional can borrow upto Rs.1.50 lakhs repayable by 12 monthly instalments in arrear calculated at a flat rate of interest of 12% per annum.

   a. Calculate the monthly repayment on a loan amount of Rs.1.25 lakhs and find the APR on the transaction.

   b. Construct a loan repayment schedule showing the loan outstanding after each repayment using.

   i. Effective Rate of Interest Method

   ii. Rule of 78

   c. Just after making the sixth monthly repayment, the borrower pays off the outstanding loan. UFC calculates the amount required for early settlement by using the modified Rule of 78 with = 1. Determine the amount payable by the borrower and the effective rate on the completed transaction.

4. Under the "Buy Now & Pay Later" scheme of Padma Financial Services (PFS) an individual with a gross annual income exceeding Rs.60000 p.a. can borrow upto Rs.40000 for acquiring consumer durables. The loan is repayable by 24 monthly instalments in arrear calculated at a flat rate of interest of 12% p.a. The Plan calls for an initial security deposit of 15% of the loan amount, which will be refunded on payment of the last instalment with interest calculated at 12% p.a convertible daily.

a. What is the effective annual rate of interest implied by the plan?

b. A customer who has borrowed Rs.30000 under the plan opts for an early settlement after paying the 18th monthly instalment. PFS calculates the amount required for early settlement using the modified Rule of 78 with + 2. Calculate the effective rate of interest per annum on the completed transaction.

Note; assume 360 days to a year.

UNIT – 10

FACTORING

10.1	Introduction
10.2	Unit Objective
10.3	Unit structure
10.3.1	Evolution of Factoring
10.3.2	Meaning & Definition of Factoring
10.3.3	Factoring Vs Bills Financing
10.3.4	Salient Features about Factoring
10.3.5	Classification
10.3.6	Export Factoring
10.3.7	Cost of Factoring
10.3.8	Legal Aspects
10.4	Summary
10.5	Keywords used in the lesson
10.6	Further reading
10.7	Answer to check your progress question
10.8	Model Questions

10.1 Introduction

Factoring is a financial service that facilities organizations to better manage their receivables. Factoring is continuing arrangement under which a financial institution takes on the credit and collection responsibilities of its clients by purchasing and recovering his trade dues.

10.2 Unit Objectives

- To know the evolution of factoring services in India
- To identify the various features and classification of factoring
- To understand the legal aspects of factoring

10.3.1 Evolution of Factoring:

The term "Factor" has its origin from the Latin word from "facers" meaning "to make or do", i.e., to get things done. The dictionary meaning of "Factoring" is "the work of a factor", the business of buying up trade debts or lending money on the security of these. Factoring still account for the maximum turn over, in most other countries factoring started much later in 1960s. Factoring in western countries evolved over a period to meet the felt needs of the market operators. The predominant characteristics assumed different shapes in different countries, though in basic form it retained the characteristic of being an instrument of service support and financial intermediation. Factors are the ability to gather adequate information about the clients and their customers as also the industry was a critical element in the growth of factoring. While in the USA, the growth of factoring

Check Your Progress
1.It is continuing arrangement under which a financial institution takes on the credit and collection responsibilities of its clients by purchasing and recovering and recovering his trade dues. which is called as ________.

business was industry specific and the main requirement of factoring was credit cover, in the UK and Europe, factoring grew as information based service system and finance was the principal influence. The real growth of factoring business came about when commercial banks came into this field during 1950-60.

10.3.2 Meaning & Definition of Factoring:

Factoring is a continuing legal relationship between a financial institution (the Factor and a business concern the Client) selling goods or providing services to trade customer (the customers) on open account basis whereby the Factor purchases the client's book debts (accounts receivable) and controls the credit extended to customers and administers the sales ledgers.

The Unidroit convention on international Factoring held in Ottawa, Canada, in May 1988, has defined Factoring as a contract concluded between one party (the supplier) and another party (the Factor) by which the factor is to provide atleast two of the following services.

(i) Finance

(ii) The maintenance of accounts

(iii) The collection of receivables and

(iv) Protection against credit risks

And the supplier is to assign to the factor on a continuing basis, by way of sale of security, receivables arising from the sales of goods or supply of services.

Robert.W.Johnson in this book financial Management States, "Factoring is a service involving the purchase by a financial organisation called a factor, of receivables owned to manufactures and distributors by their customers with the factor assuming full credit and collection responsibilities".

Factoring in India:

The Reserve Bank of India constituted a study group under the chairmanship of C.S.Kalyana Sundaram, former Managing Director of State Bank of India, to study the feasibility of starting factoring organization in India. Based on the recommendations of this study the Government of India decided to introduce factoring services with a view to mitigate the hardship being faced by small and medium enterprises in managing receivables and in order to contain the growing phenomenon of debts. Four banks were allowed to start factoring services- the State Bank of India to undertake factoring

services in the western region, Canara Bank in the southern region, Punjab National Bank in the Northern region and Allahabad Bank in the Eastern region. In addition the small industries development Bank of India (SIDBI) to provide factoring services to small and tiny sector.

10.3.3 Factoring Vs Bills Financing:

Factoring offers as a financial system (combining all the related services) a district solution used by the working capital tied up in trade debts. Factoring has many similarities with bill discounting facility, as finance is made available to the seller/supplier against invoices raised, in both cases. But however there are certain distinct differences between factoring and bills discounted bills may be rediscounted any number of times before they nature for payment.

Cost-wise also, there is a difference as a factoring is bound to cost the clients a little more atleast, than bill discounting facility. The minimum cost of factoring works out to around 20% and the responsibility for collecting the debt also rests with the factor that has to ensure that the customers pay in time unlike in bills discounting.

Factoring is a continuous relationship between the client and the factor whereas bills discounting is a facility extended or transactions basis.

Factoring is done upto a maximum of 75% or 80% only. The balance of 25% or 20% is released only when the customer makes the payment. Whereas bills finance is extended mostly on 100% basis.

In bills discounting debts represented by the receivables are assigned by the client to the factor who becomes the rightful owner of the goods represented by the bills.

Banks lends on the credit worthiness of the client whereas the factor is concerned with the standing of the clients account i.e. the debts.

Bills discounting facility is always with recourse i.e.. if the buyer fails to pay on the due date the banks has right to recover the dues from the client whereas the services provided by the factor can be with or wihtout recourse.

Check Your Progress
2. The minimum cost of factoring works out around ____ %.

10.3.4 Salient Features about Factoring:

Full factoring involves cent per cent protection against bad debt in the case of non recourse facility, guaranteed cash flow, credit management sales ledger administration and optical pre-payments. The common elements in a supplier sought by a factor are quality product

or service, experienced in the business management good system of internal control, defined terms of trade, short term contract, no sale or return or consignment selling, no stage payments, assignable debtors, minimal contra accounts, good spread of receivables and growth.

(i) Selection of Accounts:

A factor need not purchase the entire receivables of a firm. The choice of purchasing the entire receivables or part of the receivables is a credit decision. Usually the factor selects the accounts to be purchased. The terms such as credit period and average collection period are negotiated between the firm and the factor.

(ii) Debt Collection and recourse on bad debt:

The factor intimate the customer in writing to the effect that payment should be made to the factor instead of the firm or supplier. The factor may reserve the right to demand payment from the firm in case one of its customers fails to pay.

(iii) Payment by Factor:

The factor makes payment to the firm on the date agreed as the end of collection period or the day of collecting the accounting whichever is earlier. In certain cases, the agreement may provide to the firm as advance receivables uncollected and not due for payment. The limit of advance is a matter of agreement between the firm and the factor taking into account the short term finance requirement of the firm.

(iv) Factor reserve:

Usually the factoring agreement entered into between the firm and the factor provides for a certain percentage of the face value of the receivables as factoring reserve in order to protect against sales return and cash discounts. When the firm draws advance against uncollected and non due accounts the reserves are more important. The reserve amount is normally returned after the collection from the customer. The advance carries and agreed rate of interest. A diagrammatic representation of the operating mechanism is annexed.

10.3.5 Classification:

(i) Notified Factoring :

In the case of notified factoring, the customer is intimated about the assignment of debt to a factor and also directed to make payments to the factor instead of to the firm. This is invariably done by a legend on the invoice which states that the receivable arising out from the invoice has been assigned to or sold to the factor.

(ii) Non-notified factoring or confidential factoring:

This facility is one under which the supplier/factor is not declared to the customer unless or until there is a breach of the agreement on the part of the supplier or exceptionally where the factor considers him to be at risk.

(iii) With recourse / without recourse:

Factoring-whether notified or not can be further classified as with recourse and without recourse factoring. Under a with recourse agreement the supplier will carry the credit risk in respect of receivable he has sold to the factor. The factor will have recourse in the event of non-payment for whatever reason, including the financial inability of the customer to pay. Effectively the factor has the option to sell back to the supplier any receivable not paid by a customer regardless of the reason for non-payment. In without recourse factoring the bad debt is born by the factoring agent or factor. However the factor commission would be higher in without recourse factoring. With recourse factoring is similar to bill discounting scheme.

Factoring is quite popular in the developed world and over the years a variety of factoring services have been devices and perfected. These included:

(a) Full Factoring

(b) Maturity factoring

(c) Advance factoring

(d) Undisclosed factoring

(e) Invoice factoring

The special features of each type of factoring services are discussed below.

(a) Full factoring:

(1) under the category the following four services are rendered viz.,

(i) Collection of receivables and maintenance of sales ledgers.

(ii) Credit control

(iii) Credit protection i.e., insurance cover for customer' default.

(iv) Finance

Check Your Progress

3. Under this factoring, the customer is intimated about the assignment of debt to a factor and also directed to make payments to the factor instead of to the firm, called as ________.

4. The factor with the agreement that the supplier will carry the credit risk in respect of receivable is called as ________.

2) Since the factor provides the cover for the customer's default, it approves the customer as a credit risk, based on information on his credit worthiness. On this assessment, monetary limit is fixed for each customer upto which trade credit provided by the client will be taken over by the factor without recourse to the credit.

3) The client will be free to exceed the credit limit for a customer but cover would be available to him only upto the credit limit fixed by the factor.

4) The liability of the factor under without recourse service will cover only the defaults arising out of customers' financial inability to pay. If the payment is with held for reasons of dispute regarding inherent defect in goods, quality, counter claim, etc., recourse will be available to the factor against the client. The specific occasions when the factor will have right of recourse will depend upon the precise terms to the factoring agreement.

5) The trade debts will be assigned to the factor. Notice will be given to the customer that the debt is so assigned and that he will get a proper discharge of the debt if the payment of the invoice is made over the factor.

6) Prepayment of invoice is made to the client upto about 80% of the amount and the balance is paid after the agreed period expires. The factor will send analyzed statements of accounts to the client at the agreed periodically.

7) The client will be free to draw funds at any time upto the drawing limit, which will be adjusted for (i) new invoice and (ii) invoices collected.

8) The factor's charge to the client will comprises:

   (i) Charge for rendering sales ledger management and debt collection services.

   (ii) Premium for taking over the risk of debt default.

   (iii) Interest on the funds provided to the client from the date of drawing to the maturity date of the invoices.

These changes may be quoted as a single item or each component of the charge may be separately quoted.

(b) Maturity Factoring:

1) This type of factoring involves no financing ability and hence no drawing limit is made available to the client but

NOTES

the factor administers the client's sales ledger and renders debt collection service.

2) The amount of each invoice is made over the client at end of the credit term or on an agreed maturity date less the factor's charges. This maturity date is decided upon at the commencement of the agreement by references to the average time taken by the client to collect a debt. The maturity date bear no relation to the date on which the debt is actually due for payment as it is an estimated date of collection.

3) Such factoring could be with or without recourse. It is without recourse, the amount will be made over to the client regardless of whether the factor has been able to collect the invoice or not. If the debtor becomes insolvent on proof of insolvency payment will be made to the client before maturity. In with recourse factoring, the factor will either pay the client on collection of the invoice or on maturity date with recourse later on.

4) The factor's fees will comprise the following :

(i) Charge for sales ledger management and debt collection service.

(ii) In case of without recourse service, premium for taking over the risk of debt default.

(iii) In case of with recourse service when customer does not pay the invoice, interest on the funds provided to the client from the date of payment to the date of RECOVERY OF AMOUNT ADVANCED.

(c) Advance Factoring:

(1) This type also could be with or without recourse. Under this agreement the factor is prepared to pay for the debts in advance of receiving the payment due from the customers. This is only a prepayment and not an advance.

(2) A drawing limit will be made available to the client as soon as the invoices are accounted for. The factor will generally limit the amount prepaid to about 80% of debts.

(3) Besides charged for sales ledger management and debt collection services, interest for the period for which funds are paid in advance will also be charged.

Check Your Progress
5. The factoring which does not involve the financing ability is called as ______.

(d) Undisclosed Factoring:

(1) In this type of factoring, debts are assigned to the factor but the client maintains the sales ledgers of customers are not notified of the factor's involvement.

(2) The factor however gets a copy of the invoice from the client with either debt default or finance or both as desired.

(3) Debt collection is also organized by the client who makes over payment of each invoice to the factor, if advance payment has been received by him earlier.

(4) The factor keeps a check on its risk by receiving from the client and age-wise analysis of the debts at regular intervals. He can also inspect the sales ledger of the client at regular intervals.

(5) The types of services which may be offered under an undisclosed label are very flexible. They may be on non-recourse basis and/or seasonal and/or selective basis.

(6) The charges vary with the range of services provided.

(e) Invoice Factoring:

(1) This is a variant undisclosed factoring. Under this agreement the factor purchases all or selected invoices of its client at a discount. Further the factor does not maintain the sales ledger or undertake debt collection its only function being to provide finance.

(2) The advantage of this service is that the client is able to obtain short term relief from liquidity problems by taking advance without having to commit to regular factoring services.

10.3.6 Export Factoring:

. The export factor a party of the export trade transaction helps the exporter to sell the goods abroad on open account basis, makes a pre-payment to exports takes over the responsibility of maintaining sales ledger. collection of debts and provides credit protection.

Check Your Progress

6. The factor which helps the exporter to sell the goods abroad on open account basis, makes a pre-payment to exports takes over the responsibility of maintaining sales ledger, collection of debts and provides credit protection, is called as _______.

There are many small scale exporters in India, who lose their entire goods and money through export transaction. As per RBI exchange control regulations an exporter has to repatriate export proceeds within 180 days from date of shipment. With recent hike in export credit interest rates for bills outstanding beyond 90 days at the rate of 18% p.a from date of advance and bills outstanding beyond 180 days at the rate of 25% p.a from date of advance the economic losses can be imagined.

On one side exporter is faced with severe restrictions and penalty from RBI for violation of FERA regulations namely the non-repatriation of export proceeds. On the other side the steep hike in export credit interest rates, scrapping of cash compensation support and change an issue of REP licenses which hitherto was available liberally the exporter in tight spot. Under the present system of issues of license, 30% of FOB value of exports realized only and whose intricacies of earning float moneys is not much known, except some major exporters in main centers. Exporters would be happy if their proceeds are received fast without any teething troubles and the export factor plays an important role here.

a) Necessity of Export Factoring:

Export faces problems like:

(1) Credit worthiness of buyer not known in most cases.

(2) Country risks-the political and exchange control regulation of the importer country not known.

(3) Buyers or agents assurance at the time of booking contracts are all upto convincing exporter to part with the goods on their terms, which are generally with longer credit terms.

Under the present circumstance with emphasis not on just export but on repatriable, hard currency export proceeds, the relevance of export factoring is very much there.

b) Advances of Export Factoring;

(1) Prepayment to the extent of 80%.

(2) Helps exporter to utilize the resources for further expansion and volume business.

(3) It saves time, anxiety and cost involved in collection or debts to the exporter.

(4) Credit worthiness of the buyer is taken care of and trade is done with more reliable buyer.

(5) Maintenance of sales ledger accounts is done by export factor.

(6) Timely and effective collection of debts from the buyer.

(7) Credit risk protection avoids losses due to bad debts.

(8) Lengthy legal resources for non-payment avoided.

(9) The operation of exports through L/C's is costly and requires expertise to prepare documents without any discrepancy. The same are not required under export factoring.

c) Operation of Export Factoring:

The exporter approaches the export factor with full details.like:

(a) Name of the buyer.

(b) Name of Goods

(c) Terms of payment

(d) Place of destination of goods

The export factor now works further through an import factor in buyer country. The details are given to the import factor who finds credentials, credit worthiness and financial standing of the buyer. Once satisfied he assumes the credit risk and may make payment in case of default and conveys his willingness to collect the debt to the export factor. The export factor informs the import factor of the shipment and forwards the export invoice. The import fact collects the export proceeds and remits to the exporter through banking channel under advice to the export factor. The export factor can also do the collection of debts without the need of an import factor.

The export factor can charge fee for services as well as for financial charges like cost of funds, range from 0.75% to 3%. The exporters are paying premium to Export Credit Guarantee Corporation for cover on commercial and political risks. The same cost can be saved to meet the necessary fee to export factors.

With Indian Exporters being small and many exporting agriculture commodities, engineering, textile etc., the export factoring goes a long way boosting exports especially when 38% of trade is done not under L/C's and 4% of country's exports are stuck as overdue. Illustration of

how an export factor works and mechanics of export factors are annexed.

d) Impact of Factoring:

Factoring owes its origins to the win objectives of shortening the cash cycles and selling to distant or unknown purchasers. The demand and pricing of factoring services are as assessed by the Kalyana Sundaram Group in their report and the following model has been developed for making as assessment of potential demand.

ASSESSMENT OF POTENTIAL DEMAND

(in rupees)

	SSI	MEDIUM / LARGE
1. Value of output (assumed)	100	100
2. Of which credit sales constitue	80	75
3. Sales through bills (% of credit sales)	16 (20%)	25 (33.3%)
4. sales on open account (2-3)	64	50
5. Outstanding credit sales on the basis of average	16	6.25
Collection period (in days)	(90)	(45)

It emerges from the above model that about 64% of the output of the SSI sector is sold on open account basis. The value of the output of the manufacturing sector is estimated at about Rs.150000 crores in 91-92 with the SSI and medium/large sectors contributing more or less equally. As such the value of outstanding open account credit sales available for financing at any point of time would amount to Rs.12000 crores in the case of the SSI sector and Rs.5000 crores for the medium/large sector. While the extent to which banks are currently extending finance against these receivables is as much as 50% the business available to the factors is substantial. The entire sales made to the factors are substantial. The entire sales made on the open account basis (i.e. item 4 above) constitute potential business for collection services of factors.

10.3.7 Cost of Factoring:

Factoring attracts two types of charges namely, Discount charge and a service fee. The discount rate levied on the prepayment

drawn by the client normally tallies with the bank lending rate. Currently it is in the region of around 19 to 22 percent.

The service charge on the other hand range from 0.5 two percent of the invoice value, depending upon the types of factoring services rendered and the volume of transaction says M.S.R.Manjunathan, executive vice president, Canbank Factors.

The pricing of factoring services as assessed by the Kalyana Group is as given below:

Funding Cost	12 – 16%	
Collection Cost	1%	
Bad Debt Provision	1%	
Spread	2%	
T = pricing to customer :	16% – 20%	p.a
T = Bills interest	15.5%	p.a
T = Stamp duty	0.5%	p.a
T =	16.0%	p.a

According to the group the price for financing services offered by factors can be around 16% p.a and the aggregate price for all the other services may not exceed 2.5% to 3% of the debts services. Such pricing shuold enable the factors to reach a level of business which will generate reasonable rate of return on their investment.

10.3.8 Legal Aspects:

From a legal point of view, factoring creates a direct relationship between the factor and the supplier. The factoring agreement provides as under:

- The supplier gives an undertaking to sell its receivable and the factor agrees to purchase the same as per the terms of the agreement.
- The supplier certificates that the debts are valid, enforceable, undisputed and recoverable. The supplier also undertakes to

settle problems of dispute, damages and deductions relating to the bills, assigned to the factor.

- The receivable which the factor is prepared to purchase on a non-recourse basis, are those which arise from transactions approved by the factor or falling within the authorized credit limits.
- The factor stipulates that the supplier must serve a notice of assignment in the prescribed form to its customers.
- All invoices credit notes, etc., raised by the supplier must be forwarded to the factor. Also any payment received by the supplier against the factors bills must be remitted to the factor.
- The factor can assign the departments further and drawn negotiable instruments in respect of such debts.
- The agreement also specifies terms of validity and modes of termination.

Between the factor and the customer the legal status of the factor is that of assignees. As such if the goods of services provided by the supplier do not confirm to the contract, the customer has the same defenses against the factor as against the supplier. As soon as the factor purchases the receivable of the supplier and the fact is notified to the customers they are legally bound to make all remittances to the factor. Further if a customer inadvertently makes the payment to the suppliers the payment will not be valid and the supplier will be under legal obligation to remit the money to the factor.

Transfer of ownership of receivable:

The legal aspect of all factoring whether notified or non-notified is the outright purchase of the receivables of a supplier firm. The transfer of ownership of a receivable may be either by way of legal assignments or by way of equitable assignment. In both the cases the supplier firm is the assign or and the factor is the assignee. The major distinctions between legal and equitable assignments are :

Legal Assignment	Equitable Assignment
a) Should be in writing duly signed by the assignor or his authorised signatory.	Need not be in writing. The intention of the parties must be clear.
b) The customer must be served with the notice of transfer of ownership of the receivable.	Notice need not be given to the customer.

b) The assignment must be absolute must be for the whole receivable and not by way of a charge.	May be for part of the receivable only or relate to a charge on the receivable.
d) Formal	Less formal
e) Stamp duty	No stamp duty

Important legal documents suggested by the group:

(a) Standard master agreement or Factoring Agreement which provides for rights liabilities and obligations of both factor and supplier firm and procedure for with or without recourse. It spells out whether legal or equitable assignment and provides for reassignment in a with recourse factoring.

(b) The deed of assignment containing the procedure of assignment.

(c) Suppliers firm's application form.

(d) Factor's letter of offer.

(e) Sanction letter of factor containing terms and conditions of factoring service.

(f) Standard form of invoice.

(g) Form of notifications of assignment of debtor.

(h) Supplier firm's statement of receivables, financial details. Etc., duty certified by a chartered accountant.

(i) Standard formats such as daily cash report, customer wise monthly aged receivables, monthly sales turnover per customer, report of customers whose balances are close to or exceeding then credit limit, etc., with respect to maintenance of the sales ledger.

Advantages of Factoring Services:

The major advantages of factoring services are as follows:

- The companies which want to boost cash flow and increase capacity utilization can promptly get 80 percent of the net value of their debtors from the factor.

Check Your Progress

7. An Agreement which provides for rights liabilities and obligations of both factor and supplier firm and procedure for with or without recourse is called as _____.

- It will reduce the pressure and time on chasing debts and eliminate to a great extent the risk of customers moving to other parties on repeated demands.
- Factors which are generally automated will offer comprehensive service of total sales and accounts administration.
- It will improve the working capital management by quick cash inflows. Factors provide terminals so that management is fully aware of the book debts and turn over.
- As the money is borrowed for a fixed time, costs are reasonable and can be further reduced. Borrower/client will pay service charge for the funds he will use.
- It helps in improving the current ratio of the company.
- More management time for production, sales and planning is available.
- Closer security by factors brings down based debts.
- Provides advice to clients on production, sales and marketing problems.
- There are a few distinct advantages where a "Factor is supported by a bank".
- Banks could make available to their factoring arms, funds at the same cost to their own branches. The factor is thereby free from the problems of raising funds. With the bank's support factors will be also to offer financial services to the client at a cost which is at per with the financial service offered by the bank.
- The bank's image helps the factor in building business credibility and connections.
- Credit information is readily shared to the mutual advantage of the bank and the factor.

Risk Involved:

Factoring involves risk. The risk is associated with financing business the supplier risks and the risks associated with the non-resource element of the business where applicable, i.e.. the assumption on the credit risk on the customer- the debtors risk.

Factors cover only the risk of debt default arising out of buyer's insolvency or financial inability to pay, 100% cover is provided only upto 80%. Defaults occurring on account of commercial disputes between the parties are not covered by factors.

In International factoring political risk assumes importance. Factors can cover risk through organizations like the Export Credit Guarantee Organization.

By exception factors can obtain reinsurance over through insurance companies. One shape of such cover generally obtained by factors is to cover the losses beyond a certain amount.

Prohibitive cost involved also adds to these problems. With the violent fluctuations in call money rates in the Indian money market due to dearer funds position the possibility of the cost of operations of the factors going up correspondingly cannot be ruled out in future, as they may have to rely mainly on the money market for financing their operation. This will again result in increased charges for the factoring clients which make the proposition unprofitable in course of time. This problem will not be encountered if cheaper sources of funds are available.

Other aspect includes dangers like overtrading, mismanagement and even perpetration of possible frauds. Way of fictitious or duplicate invoicing so factoring is a high risk venture fraught.

Limitations of Factoring:

Though the use of factoring is not limited to any one industry or a few lines of industry, there are certain classes of business, a mentioned below, which are not suitable for factoring.

- Business selling principally for cash.
- Entire output sold to one or a few companies of good credit standing.
- Not available to firms whose financial position or management is unsound.
- Factoring is a continuing arrangement and not a source of emergency finance.

Why is factoring not catching on?

There are genuine capital operational problems. Factoring is a fund based activity and the large resources requirement of factors necessarily implies that the capital base of the factoring company must

be large to meet the fund commitments and to have a large borrowing power. Factors should have access to refinance from the development finance institutions like DELHI, IDBI, etc.

The second problem relates to the criteria for assessing clients to doing business the upper limit for doing business, the profitability, disputes and debts record the spread of receivables and the incidence of credit notes i.e., recovery/repayment criteria have to be clarified more. Canbank Factors has fixed an upper limit of Rs.2 to 2.5 crore for small and medium industries that is about 25% of the existing net worth of the company.

The third major problem lacuna is credit information. Factoring companies in the near future will have to start credit information services for conducting business better. In fact the Reserve Bank of India has suggested that all factoring agencies get together and start such a service.

The fourth is stamp duty. Factoring is considered as an assignment of debt. So it attracts stamp duty. The question that arises is who will bear this cost? Whoever bears them the cost of factoring goes up? Factors have been pressing for the removal of this duty.

Fifth, the companies are finding that the regional criterion recommended for the operation of factoring agencies of nationalized banks is leading to trouble. M.V.Prabhu. a managing director of Canbank Factors, points out, white the seller (the client) takes place in our region, the buyers (customers) are spread all over the country, in which case carrying on liaison work becomes very difficult.

The most important resistance however comes from within, i.e., the banking system. To solve this problem, workshop should be conducted and misconceptions removed.

M.V.Prabhu is confident that in the next two or three years the acceptability of factoring will substantially increase and by 1996-97, it will be well established in India.

M.N.Dandekar, managing director. SBI Factors feels, with the west zone accounting for approximately 30% of the All India Market, SBI factors, will touch Rs.600 crore marks by 1996. Factoring and bills discounting will take care of working capital by the end of the VIII Fiva Year Plan.

10.4 Summary:

Indian financing organizations are on the constant lookout for newer opportunities of growth and profitability. Newer forms of financing that are available in advanced countries are being introduced in the Indian Market. One such type of finance is factoring. The

Reserve Bank of India is keen on promoting factoring services in India to meet the requirements of short term financing based on receivable, instead of cash credit systems.

The trends and the requirements of the factoring services in India have been analyzed to determine key result areas. For any start up organization it is imperative to be stable and operate at an acceptable level of profits. Factoring activity needs to be self sufficient without any subsidy from the other operation. The success of this operation depends on a number of elements as given below.

- Selection of credit worthy clients and customers so that the risk in factoring is within a manageable limit. Selection should be based on credit information of the parties. The credit information collected from outside agencies like banks and CRFISIL and from regular factoring operations with the clients and customers have to be captured and processed to take appropriate decisions.

- Ability to create and market better and newer products and services that customers would pay for.

- Maintain a competitive cost of operation. Factoring is essentially a financial service and the key cost of the business would be the average information technology processing cost of a transaction in the organization.

- Effective management of operation to reduce drudgery of routine work and to make the factor's work more investigate and customer oriented. This would also include handling higher volumes of work with minimum investments on infrastructure and people.

Nowadays customers are demanding better service and are not ready to accept less than the best competitively available. Services provided may have to be differentiated depending on the size and credit worthiness of the clients and customers. Customer service would be of the deciding elements in attracting blue chip clients by the factor.

The introduction of factoring services has opened the flood gates for needy customers and there is scope for more players in the market. Factoring the answer to every company's cash flow problem will definitely emerge out of the close in the years to come. With liberalization on the anvil, this is one area promising lucrative business.

10.5 Keywords used in the lesson

✓ Factoring
✓ Classification of factoring

✓ Risks in factoring

10.6 Further reading

Indian Financial System: Markets, Institutions and Services, 2/e Pearson Book

Indian Stock Market by Bishnupriya Mishra

The Indian Financial System: Markets, Institutions and Services, 3/e, by

Bharati V. Pathak

10.7 Answer to check your progress question

1. Factoring
2. 20
3. Notified factoring
4. Recourse factoring
5. Maturity factoring
6. Export factoring
7. Factoring agreement

10.8 Model Questions

1. What is meant by factoring? Differentiate Factoring and Bills Financing.

2. Discuss various classification of factoring.

3. Critically examine the legal aspects of factoring

Illustration of how an Export Factor Works

1. An exporter (client) submits to the Export Factor (EF) a buyers' (customers) list indicating their names and street addresses and his credit line needs.

2. The import factor (IF) selected by EF rates the buyer's list. The results are reported to the exporter.

3. The exporter enters into an export factoring agreement with EF. All export receivable are assigned to EF, who in turn assigns them to IF.

4. Export orders are credit approved. The approval of credit lines usually takes between 48 hours and two weeks, depending on how easily credit information about the buyers can be obtained.

5. The explorer ships merchandise to approved foreign buyers. Each invoice is made payable to a specific factor in the buyers country. Copies of invoice and shipping documents are sent through EF to IF.

6. If it follows up, if receivables are not paid on the invoice due date. It collects in accordance with local practices and assists in resolving disputes. It holds receivables on its books for 60 days after receiving notice of a dispute, thus allowing the party's time to resolve it.

7. If remits payments received from buyers to EF immediately. EF converts foreign currency remittances and makes weekly funds transfers of all proceeds to the exporter.

8. If an approved buyer is financially unable to pay, if pays the receivables to EF 100 days after the due date and the funds are included in the next weekly payment to the exporter.

9. EF provides the exporter with a monthly report showing the status of each receivable.

10. EF also makes advances to an exporter against approved receivables.

1. The seller delivers goods to his debtors.

2. The seller assigns his accounts receivables through EF to IF who assumes the credit risk, provided this had been agreed to before hand.

3. EF pays the agreed advances to the seller.

4. IF deals with the accounts receivable in accordance with the sales contract existing between the seller and the debtor.

5. The debtor pays on the due date to IF, who transfers the amount to EF.

6. EF settles the advance that had previously been made and remits the balance to the seller.

4. The seller ships the goods to his debtor.

5. The seller assigns his invoices to EF.

6. EF pays the seller the agreed advance.

7. EF handles the accounts receivables in accordance with the sales contract between the seller and the debtor.

8. The debtor pays on the due date to EF.

9. EF settles the advance with the funds received and forwards the balance to the seller.

1. The parent company ships good to its subsidiary which sells and ships the goods to the debtors in IF's country.

2. The seller assigns his invoices on the subsidiary via EF to IF.

3. The subsidiary assigns its receivable to IF with or without credit risk coverage.

4. EF pays the parent company the agreed advances.

5. The subsidiary's debtors pay IF.

6. IF distributes the funds according to instructions from EF.

7. EF settles the balance with seller.

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Model Question Paper

M.B.A. DEGREE EXAMINATION, MAY 2002

Third Year

Elective – MANAGEMENT OF FINANCIAL INSTITUTIONS

(For those who joined in July 1999 or earlier)

Time: Three Hours
Maximum: 100 marks

Answer any FIVE questions

All Questions carry equal marks.

1. Critically evaluable the present state of Indian Financial System.

2. Discuss the functions of UTI and highlight the contributions of it on the Indian Capital market.

3. What is a financial lease? How do the income tax aspects affect the lease related cash flow streams of the lessor and the lessee?

4. What is the debt displacement effect of leasing?

5. Discuss the role of merchant banks in managing public issue and the SEBI's regulation in this regadd.

6. What is venture capital? What are the characteristic features that distinguish it from other capital invetsments?

7. Discuss how performance of mutual funds can be evaluated. Critically appraise the performance of mutual funds in India.

8. Discuss the concepts of money market mutual fund. How does it operate in India?

9. Discuss the SEBI guidelines for arranging International Finance.

10. Write notes on any THREE of the followings.
    (a) Factoring.
    (b) Hire Purchase
    (c) Intercorporate loan
    (d) Post shipment credit
    (e) GDR.